COMPLETE PRACTICAL INCOME TAX

A. G. McDADY

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E.J.R.

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PREFACE TO FOURTH EDITION

THE Author takes the opportunity of again expressing appreciation of the gratifying support which those interested in the subject of Income Tax continue to give to this book.

The process of simplification of the Income Tax is now apparently completed and accordingly Finance Acts of the immediate future should not present the difficulties and complexities of those of recent years.

The Author repeats the invitation made in an earlier edition that he is glad to receive suggestions regarding the treatment in the book of any aspect of the subject which may occur to readers.

The book has been brought up to date in accordance with recent Case Law or Board of Inland Revenue concessions or rulings so far as these have been made known.

A. G. McB.

August 1928.

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RATES OF INCOME TAX, SUPER TAX AND SUR-TAX

FROM

1922-23 TO 1928-29.

INCOME TAX.

1922-23	Standard Rate	5/-
1923-24	,,	,, 4/6
1924-25	,,	,, 4/6
1925-26	,,	,, 4/-
1926-27	,,	,, 4/-
1927-28	,,	,, 4/-
1928-29	,,	,, 4/-

SUPER TAX AND SUR-TAX.

RATES FROM 1921-22 TO 1924-25, INCLUSIVE.

Part of Income	i.e. Part between	Rates
		s d
First £2,000 of income	£0 and £2,000	Nil
First 500 above £2,000	£2,001 ,, 2,500	1 6
Second 500 ,, 2,000	2,501 ,, 3,000	2 0
1,000 ,, 3,000	3,001 ,, 4,000	2 6
1,000 ,, 4,000	4,001 ,, 5,000	3 0
1,000 ,, 5,000	5,001 ,, 6,000	3 6
1,000 ,, 6,000	6,001 ,, 7,000	4 0
1,000 ,, 7,000	7,001 ,, 8,000	4 6
12,000 ,, 8,000	8,001 ,, 20,000	5 0
10,000 ,, 20,000	20,001 ,, 30,000	5 6
All above £30,000	30,001 and upwards	6 0

RATES FROM 1925-26.

First £2,000 of Income	£0 and £2,000	Nil
First 500 above £2,000	2,001 ,, 2,500	0 9
Second 500 ,, 2,000	2,501 ,, 3,000	1 0
1,000 ,, 3,000	3,001 ,, 4,000	1 6
1,000 ,, 4,000	4,001 ,, 5,000	2 3
1,000 ,, 5,000	5,001 ,, 6,000	3 0
2,000 ,, 6,000	6,001 ,, 8,000	3 6
2,000 ,, 8,000	8,001 ,, 10,000	4 0
5,000 ,, 10,000	10,001 ,, 15,000	4 6
5,000 ,, 15,000	15,001 ,, 20,000	5 0
10,000 ,, 20,000	20,001 ,, 30,000	5 6
All above £30,000	30,001 and upwards	6 0

CHAPTER I

ADMINISTRATION

Commissioners, Appeals, Assessors, Collectors, Inspectors, Returns and Assessments

GENERAL

Income Tax is theoretically a temporary tax, but in effect is really permanent, as it is re-imposed annually by the Finance Act.

The fiscal year for Income Tax runs from 6th April to 5th April following, and between 6th April and the date of passing of the annual Finance Act, the pre-existing provisions relating to the levy and the collection of Income Tax are kept in force by the "Provisional Collection of Taxes Act." Legal permanency in respect of Income Tax matters is thus ensured.

As a knowledge of procedure is necessary for a proper understanding of Income Tax, it has been thought well to devote a chapter to administration.

COMMISSIONERS

All duties of Income Tax are under the care and management of the Commissioners of Inland Revenue, Somerset House, London. The actual assessments, however (with the few exceptions specifically provided for in the Act),

are finally "allowed" by two bodies, the General Commissioners and the Special Commissioners. The taxpayer, on his Return Form, can elect to be assessed by either in respect of his Schedule D liabilities. The assessments are not "made" by the Inspector. His duties are to watch the interests of the Inland Revenue. For this purpose the country is divided into areas known as Districts, each in charge of an Inspector of Taxes.

General Commissioners.—They are usually seven in number, and fill vacancies themselves. In most cases they are prominent business men or land owners in the district, are unpaid, and must possess a certain property qualification. They appoint a Clerk, who keeps notes of their proceedings and issues Assessment Notices on their behalf. He is a salaried official, but is not a Civil Servant. He may carry on another business. These General Commissioners may appoint two or more "Additional Commissioners," and to them is delegated the whole task of "making" Schedule D Assessments. These Additional Commissioners may or may not be chosen from the General Commissioners.

Special Commissioners.—They are Civil Servants and are located at 23 Kingsway, London. A number of them are continuously on circuit, and visit the large centres about twice a year. Two of them constitute an Appeal Court. Where the one differs from the other "in accordance with the usual practice, the decision is given in favour of the taxpayer."

APPEALS

Before General Commissioners.—The taxpayer can be represented by an Agent, and need not be present. (Same before Special.)

The taxpayer can insist that the Inspector also withdraw if he (the taxpayer) is requested to withdraw by the Commissioners.

The taxpayer who desires to object to an assessment made upon him must give notice in writing to the Inspector within twenty-one days after the date of the notice of assessment.

The taxpayer can appeal from a decision of the General Commissioners only on a point of law. (Same before Special, but see below.)

It is often very difficult to distinguish between "law" and "fact" in Income Tax, and should there be any possibility of the Commissioners' decision on a point of law being appealed to the Law Courts, the taxpayer or agent should state at the appeal that he desires to express dissatisfaction with the decision as being erroneous in point of law. Thereafter, an intimation of the demand for a case for the opinion of the High Court (in England) and Court of Session (in Scotland) must be intimated within twenty-one days.

Before Special Commissioners.—Although Civil Servants, the Special Commissioners are an extremely impartial body of men with a specialised knowledge of Income Tax.

Where the taxpayer on his Return Form has elected to be assessed by the Special Commissioners he can appeal against the decision of the Special Commissioners "in any particular" (i.e. fact or law) to the Commissioners of Inland Revenue, London.* This, however, is a privilege little used, and for fuller information the reader is referred to Section 147 of the Income Tax Act, 1918.

The Special Commissioners sometimes reserve their decision to enable them to deliberate at greater length on the point(s) and communicate their decision later by post.

*NOTE.—This, of course, is after a decision has been given by the Special Commissioners on appeal.

General.—The Finance Act of 1926 created an obligation in connection with appeals against assessments under Schedule D or the rules applicable to that Schedule which was already of almost universal application in practice. On the notice of appeal the appellant must specify the grounds of the appeal. Incidentally, it is within the powers of the Commissioners hearing the appeal to go into any ground of appeal which was not specified on the notice, if the omission of that ground from the notice was, in their opinion, " not wilful or unreasonable."

From 1926-27 onwards, the collection of tax is to be held over, as a result of an appeal against an assessment, only to the extent to which the assessment is affected by the matter in dispute. Such part of the assessment, if any, as may be considered to be unaffected by the issue of the appeal will be confirmed by the Commissioners in the ordinary way, and collection of the tax thereon will proceed on normal lines and the usual machinery of collection or recovery may be put into operation.

ASSESSORS

They are appointed by the General Commissioners. Their duties are to issue, as early as possible in the year of assessment (generally April), Return Forms for all Schedules to all known liable persons. These Forms are known as " particular notice," and simultaneously with their issue, a notice to all liable persons calling upon them to lodge a return of income is posted up at the Parish Church door in each district. This is called a " general notice." A general notice has all the strength, in law, of a particular notice. The Assessors " make " the assessments under Schedules A, B and E. In practice all the actual work, including the calculation of the assessable figure, is carried out in the Inspector's office.

COLLECTORS OF TAXES

They are the cashiers for the collection of the tax. They have nothing to do with the manner or basis upon which the tax is computed. Their duties are confined to collection of cash purely, and dissatisfaction with a notice of assessment must be intimated to the Inspector of Taxes and not to the Collector.

In Scotland, the Notice of Assessment and First Demand Note are both contained in the one notice.

INSPECTORS OF TAXES

They are appointed by the Treasury, act under the directions of the Commissioners of Inland Revenue and are Civil Servants. They receive the Return Forms from the Assessors and call for production of Financial Accounts and explanations of the various charges, &c., included in such Accounts. Any correspondence arising out of the Return and Accounts is conducted from the Inspector's office. In practice, the taxpayer agrees his computations with the Inspector and only in very exceptional cases will the Additional Commissioners reject the agreed figures.

RETURN FORMS

These are issued in April of each year.

There are separate forms for Schedules A, B, D and E. (The taxpayer is not directly concerned with Schedule C. This Schedule covers income in the nature of interest, annuities, dividends, &c., payable in the United Kingdom out of *any public* revenue in the year of assessment. Such income is paid under deduction for tax and is, therefore, not assessable on the recipient. This Schedule is accordingly not dealt with in this book.)

They are issued to the taxpayer in the district where he

carries on business or is employed. If not employed in business in any way he will be assessed at his residence. If the taxpayer is a director of several companies or has more than one business or employment, he will probably receive a Return Form in respect of each subject, but as the statutory obligation is to render one Return of Total Income only each year, surplus forms should be returned with a reference to the complete Return which has been made.

The taxpayer is asked to state on the Return whether he desires his Schedule D liability to be assessed by the General or Special Commissioners. If this space is left blank he will be assessed by the General. If assessed by Special Commissioners it means that :—

(*a*) Financial Accounts will be lodged and agreed with the Inspector in the usual manner.
(*b*) The Inspector sends the Return and relative papers to the Special Commissioners, London, and they approve assessment.
(*c*) The Notice of Assessment is issued by the Special Commissioners, London.
(*d*) The Demand Note is issued by the Special Commissioners, London.
(*e*) There is no right of appeal to the General Commissioners. (If assessed by General there is a choice of appeal to either General or Special.)

ASSESSMENTS

Income Tax assessments are made for each Income Tax year, but if it is discovered that the liability is insufficiently assessed for any particular year, the revision of the liability is effected by raising Additional Assessments for that year. The Additional Assessments may be raised within six years of the year of original liability sought to be revised.

CHAPTER II

It would appear that for the present, at any rate, the expressions "assessable" and "taxable" income which in terms of Section 40 Finance Act, 1927, were to be superseded, are to remain, and the method of granting allowances in terms of tax *after* tax had been calculated at the standard rate on the assessable income is not, in practice, to become operative.

The old system of granting allowances quantitatively from the gross amount of the assessment will continue and tax will be calculated as before on the remaining taxable income.

ALLOWANCES & RELIEFS

Earned, Personal and Family, Life Assurance and Reduced Rate Relief

EARNED INCOME

Earned Income.—This may be broadly defined as Income acquired as a result of personal effort on the part of the taxpayer.

The following are, therefore, treated as earned income :—

Business Profits (except Sleeping Partner's share and profits of a limited company).

Remuneration from Employment.

Pensions, including allowances granted to survivors of a deceased person in respect of past services of the deceased. (Disability pensions are specifically exempted.)

Value of Property which forms part of the emoluments of any employment. (If there is no power to sub-let, the value of the property is not treated as income of the occupier.)

Civil List Pensions granted under the Civil List Acts.

The allowance in respect of earned income is one-sixth of the amount of that income, and it should be noted that :—

(*a*) The allowance does not exceed £250 in the case of any individual.

(*b*) In a partnership assessment each partner receives the allowance from his share up to the limit of £250 ; thus the aggregate earned income allowance in the firm assessment may exceed £250.

(*c*) If the income of the husband includes any earned income of his wife, an addition to the £225 (see below) is made—subject to a maximum allowance of £45—to the extent of five-sixths of the wife's earned income. This is known as "Wife's Earned Income Relief." It should be noted that the one-sixth of the wife's earned income will be allowed normally as earned income relief.

(*d*) Limited Companies do not receive the allowance.

(*e*) The allowance is not a "claim" but is given by the Act. That is why it may be given in Assessment Notices where no Return Form has been completed, and where, on the other hand, no allowance in respect of, say, children, is made, although the taxpayer is entitled to the child allowance. The granting of such an allowance is conditional upon the furnishing of a statement of total income.

(*f*) The allowance is not given in respect of the share of a sleeping partner.

Income, after deduction of earned income relief (if any), is known as **"assessable income."** "Assessable income" after deduction of personal and family allowances is known as **"taxable income."**

Age Allowance.—Where the taxpayer and/or his wife (who must be living with and maintained by him) is 65 years of age or more at the beginning of the year of assessment earned income relief may be claimed on all income whether **earned or not** provided that the total income for the year of assessment does not exceed £500. This condition is modified to the extent that where a taxpayer whose total income is so little in excess

of £500 that he will be penalised thereby, he shall be allowed relief to bring his tax down to (*a*) the tax to which he would have been liable if his total income had been £500, plus (*b*) one-half of the excess of this income over £500. This relief operated for the first time for the Income Tax year 1925-26.

PERSONAL AND FAMILY ALLOWANCES

Personal.—In the case of an unmarried taxpayer the first £135 of assessable income is exempt, and in the case of a married taxpayer whose wife is living with him the exemption is £225. It should be noted that the full £225 may be claimed by a taxpayer who marries at any time within the year of assessment, and that all personal and family allowances are allowed in full for the year in which death may take place. These personal allowances are supposed to cover the cost of "living necessities," it being a principle of good taxation that Income Tax must not encroach upon the cost of living necessities. The allowance is called "personal allowance."

Children.—In respect of children, there is an allowance of £60* for the first child and £50* for each other child. To obtain this allowance the following conditions must be satisfied :—

(*a*) The income of the child must not exceed £60 per annum. (Bursaries and Scholarships are not included in reckoning the income.)

(*b*) The child must be "living at any time within year of assessment," and under 16 years of age, at 6th April in the year of assessment, or, if over 16 years of age, receiving full-time instruction at a School, University, or other Educational Establishment.

*Altered by Finance Act, 1928. Previously the allowance was £36 for the first child and £27 for each other child, while the income limit was £40 and the allowance applied only to children living and under 16 years of age at 6th April of the year of assessment.

The term child includes a step-child or adopted child if maintained by, and in the custody of, the claimant.

Housekeeper.—If the taxpayer is a widower or widow and has any person (whether relative or not) resident with him or her as a housekeeper he or she may claim an allowance of £60. There is no allowance, of course, where the housekeeper is a married woman living with her husband, and the husband has claimed the marriage allowance in respect of such housekeeper. The allowance is also given in the case of an **unmarried** person who proves that he has living with him either his *mother* (being a widow or living apart from her husband) or some *other female relative* for the purpose of looking after any brother or sister of his, being a child in respect of whom an allowance may be claimed in the usual way.

Dependent Relative.—If the taxpayer maintains at his own expense any person, being a relative of himself or his wife, who is incapacitated by old age or infirmity from maintaining himself or herself, or his wife's or his own widowed mother, whether incapacitated or not, he is entitled to claim an allowance of £25 in respect of each such person. The dependent relative's income, however, must not exceed £50 per annum. Where the taxpayer, by reason of old age or infirmity of himself or his wife, is compelled to depend upon the services of a daughter resident with and maintained by him he may claim a similar allowance. The income limit of £50 does not apply in this case.

General.—Where a partner's share of his firm's assessment is less than the total allowances, under the foregoing headings, to which he is entitled, any surplus of allowances cannot be set off against any other partner's share of firm income.

LIFE ASSURANCE

The taxpayer who takes out a Life Assurance Policy or contracts for a deferred annuity upon his own life or the life of his wife is entitled to relief at the " appropriate rate " on the amount of the allowable premiums *paid by him in the year of assessment.* (It should be noted that the taxpayer is not entitled to relief in respect of premiums on policies covering the lives of children or any other person. Where, however, the wife pays life assurance premiums either on her own or her husband's life, such premiums operate for relief in the ordinary way.)

The relief is given by deducting from the tax payable on the taxable income an amount equivalent to tax at the " appropriate rate " on the amount of the allowable premiums. This relief is given equally from each instalment where the tax is payable in two instalments.

The following restrictions are applied to the calculation of the relief due :—

(*a*) The premium allowable must not exceed 7 per cent. of the capital sum assured by any single policy. The capital sum for this purpose is exclusive of bonus or profits.

(*b*) The total amount of allowable premiums must not exceed one-sixth of the taxpayer's total net statutory income (which is defined in the next chapter).

The following distinctions have to be observed in the treatment of allowance for Life Assurance premiums :

Policies taken out after 22*nd June* 1916.

(*c*) Relief in respect of *all* policies taken out after 22nd June 1916 is restricted to one-half of the standard rate of tax for the year of assessment, i.e. in the case of these policies, the " appropriate rate " is always one-half of the standard rate.

(*d*) No allowance is made except in respect of policies which secure a capital sum payable at death.

Policies taken out on or before 22nd June 1916.

(*e*) The " appropriate rate " of tax to be deducted varies according to the total income for the year of assessment. The rate is arrived at as follows :—

(1) One-half standard rate—Where the total income does not exceed £1,000.

(2) Three-quarters standard rate .. .. —Where the total income exceeds £1,000 but does not exceed £2,000.

(3) The standard rate —Where the total income exceeds £2,000.

(*f*) In the case of payments on policies which do not secure a capital sum at death the amount on which relief for the year of assessment is to be calculated must not exceed in the aggregate £100.

(*g*) A system of marginal relief is provided for those cases where, if the claimant's income falls slightly short of the limits of £1,000 or £2,000 referred to in (*e*) above, he would, after receiving life assurance normally due, be liable for more tax than would be due if his income were actually greater. This system operates as follows : —

In addition to the normal relief at the " appropriate rate," there is allowed :—

(1) A sum equivalent to tax at one-quarter of the standard rate on the amount of the premiums, diminished by

(2) A sum equivalent to tax at the standard rate on the amount by which the taxpayer's total income falls short of £1,000 or £2,000.

Assume a total income for 1928–29 of £998 and premiums of £100 (pre-June 1916) :—

	£ s d	£ s d
Normal relief will be £100 at 2/0 ..		10 0 0
But calculated as above the following addition to this allowance falls to be made :—		
£100 at 1/0 (one-quarter standard rate)	5 0 0	
Less £2 (£1,000 *less* £998) at 4/0 (standard rate)	0 8 0	
Marginal Relief		4 12 0
		£14 12 0

Where the taxpayer claims allowance for premiums on policies, some of which were taken out on or before 22nd June 1916, and others after that date, and the total amount of allowable premiums falls to be restricted to one-sixth of the total income, the restriction should be made primarily from the allowable amount of the premiums on policies dated after 22nd June 1916. This is to ensure that the maximum relief is obtained where " appropriate rates " apply.

REDUCED RATE RELIEF

In calculating tax on taxable income the first £225 is charged at one-half of the standard rate for the year of assessment, and the remainder at the full standard rate.

Where a taxpayer's total income includes any income received under deduction for tax (which is always deducted by reference to the full standard rate of tax) he may claim to have the excess of tax suffered by him set off against tax due by him on his **taxable income** in direct assessments to the extent to which the latter falls short of £225 (on which the half-rate only is payable) or to the extent

of the amount of the income taxed by deduction whichever is less. Where the taxpayer's income is all received under deduction for tax such relief for tax over-deducted must be claimed by way of repayment.

This relief is given, as far as possible, in arriving at the tax payable in the first instalment. It should be noted that the taxed income on which relief may be due is the income receivable in the year of assessment and not the taxed income of the preceding year. In practice, however, the amount of the preceding year's taxed income is provisionally adopted.

The following examples afford a practical illustration of the foregoing.

EXAMPLE I

A.'s Income Tax Return for 1927-28 shows the following :

(*a*) Profits from business of coal merchant (agreed with Inspector) £324
(*Assessable Case I, Schedule D.*)

(*b*) Bank Deposit Interest £20
(*Assessable Case III, Schedule D.*)

(*c*) House which he owns and occupies.
(*Assessable No.* 1, *Schedule A.*)

Net Schedule "A" Assessment £30

(*d*) Income from shares in X.Y.Z. Co., Ltd.—
Gross amount £40

Charges on Income :—
Ground Rent on Residence £5

He claims the following allowances :—

(*a*) Wife.
(*b*) One child, born 31st January 1912.
(*c*) Life Assurance :—

(1) Policy for £200 on own life, taken out 30th June 1912—annual premium £11 10s.

(2) Policy for £250 on wife's life taken out 31st August 1918—annual premium £19.

Calculate the total tax payable by A. in direct assessments on him for 1927-28.

A.'s total net statutory income is £409 as follows :—

Profits	£324
Interest	20
House	30
Dividends	40
	£414
Less Charges—Ground Rent ..	5
	£409

Life Assurance.

(*a*) Allowable premium is £11 10s. (under 7 per cent. of capital sum)	£11	10	0
(*b*) Allowable premium is £17 10s. (being 7 per cent. of capital sum in place of £19 paid)..	17	10	0
	£29	0	0

No further restriction of this amount falls to be made as it is not in excess of one-sixth of total net statutory income as above.

TAX PAYABLE BY A.

The following contractions will be used in detailing the allowances and reliefs in examples, and the reader is particularly requested to make himself familiar with them.

E.I.R. = Earned income relief.
W.E.I.R. = Wife's earned income relief.
P.A. = Personal allowance (£135 single and £225 married).

Ch. = Children.
D.R. = Dependent Relative.
Hkr. = Housekeeper.
L.A. = Life Assurance.
R.R. = Reduced Rate.
R.R.R. = Reduced Rate Relief.
A.A. = Age Allowance.

Case I Assessment on Profits £324

				Tax
Less—E.I.R. .. £54				
P.A. 225				
Ch. 36				
—	315			
	— 9 at 2/–	£0	18 0	
Less—L.A. (part only required to exhaust) ..	9 at 2/–	£0	18 0	
				Nil

Case III Interest.—

£20 at 2/–	£2	0	0
Less—L.A. £20 at 2/– (balance) ..	2	0	0
			Nil

Schedule A Assessment.—

Net £30 at 2/–	£3	0	0
Less—R.R.R. on Taxed Dividends (part to exhaust) £30 at 2/– ..	3	0	0
			Nil
Total Tax Payable			Nil

But it should be noted that A. can claim repayment on a further £5 of his taxed dividends. No relief is due on the remaining £5 (total £40, less £30, on which relief has been granted in Schedule A above, plus £5 on which repayment may be claimed) as this amount is taken to cover the tax due to the Revenue on the charges, viz. Ground Rent £5 from which A. has deducted tax at time of payment.

EXAMPLE II

B.'s Income Tax Return for 1928-29 shows the following :

(*a*) Profits from business as Chemist (agreed with Inspector)	£850
(*b*) Wife's Salary as School Teacher	250
(*c*) War Loan Interest (Wife's)	25
(*d*) War Loan Interest (own)..	50
(*e*) Residence, owned and occupied (net)	30
(*f*) Income from Investments in A.B.C. Co., Ltd. (gross)	50

Charges.—

Ground Rent on Residence	£5
Mortgage Interest 5 per cent. on £200	10

He claims the following allowances and reliefs :—

(*a*) Wife.

(*b*) Three Children—(1) Born 31st March 1911.
(2) ,, 28th August 1912.
(3) ,, 31st March 1915.

(*c*) Widow mother residing with him who has £50 income of her own and is supported by him, nobody else contributing to her maintenance. He claims for her as

(1) Housekeeper to look after his children while his wife is at School or alternatively as

(2) Dependent Relative.

(*d*) Life Assurances as follows :—

(1) Policy for £1,500 on own life taken out 20th August 1912—annual premium £130.

(2) Policy for £1,000 on own life taken out 31st October 1916—annual premium £120.

(3) Policy for £750 on wife's life taken out 18th August 1917—annual premium £45.

(4) Policy for £250 on each child taken out 31st January 1918—annual premium £25 each.

(5) Lump sum payable after twenty years to self or heirs contracted for 31st August 1917—annual payment £150.

Calculate the total tax payable by B. in direct assessments on him for 1928-29.

B.'s net statutory income is £1,240 as follows :—

Profits	.. ..		£850
Wife's Salary	.. ..		250
Interest, Wife's	.. ..		25
Interest, Own	.. ..		50
Property	.. ..		30
Taxed dividends	.. .. ..		50
			£1,255
Less Charges :—			
Ground Rent	.. ..	£5	
Mortgage Interest	.. ..	10	
		—	15
			£1,240

Life Assurance.—

(*d*) (1)	Allowable premium is (being 7 per cent. of £1,500)	£105
(2)	Allowable premium is (being 7 per cent. of £1,000)	70
(3)	Allowable premium is (not in excess of 7 per cent.)	45
(4)	Allowable premium is (policy not on own or wife's life)	Nil
(5)	Allowable premium is (Contract after 22nd June 1916 and no capital sum payable at death)	Nil
		£220

The £220 of allowable premiums will fall to be restricted to £207, being one-sixth of total net statutory income as above. In making the allowance for Life Assurance the following premium will be allowable at 3s. (the rate appropriate to the total income), viz. *(d)* (1) £105. The balance, £102 (£207 less £105), will be allowed at half standard rate, because the remaining policies are post 22nd June 1916. It will be observed that, as pointed out, any necessary restriction is made primarily from post 1916 premiums in calculating the Life Assurance allowance where restriction to one-sixth of total income applies.

Allowance for widowed mother as a housekeeper is not competent as the claimant is not a widower. Dependent Relative allowance will be made as the dependent's income is not in excess of £50.

TAX PAYABLE BY B.

	£	£ s d	*Tax* £ s d
Case I Assessment on Profits ..	850		
Less: E.I.R.	£142		
P.A.	225		
Ch. (60+50)=	110		
Note.—No allowance for child born 31st March 1911—over 16 at 6th April 1928.			
D.R.	25		
	— 502		
	£348		
R.R. .. £225 @ 2/-		22 10 0	
123 @ 4/-		24 12 0	
		47 2 0	
Less: L.A.—£105 @ 3/-	£15 15 0		
and £102 @ 2/- ..	10 4 0		
		25 19 0	
			21 3 0

				Tax
Forward			21	3 0
Husband for Wife's Salary (Schedule E).				
Salary ..	£250			
Less: E.I.R. ..	£42			
W.E.I.R.	45			
	— 87			
163 @ 4/-			32	12 0
Case III Interest—				
Husband for wife—£25 @ 4/-			5	0 0
Own—£50 @ 4/-			10	0 0
Schedule A Assessment—Net £30 @ 4/- ..			6	0 0
Total Tax Payable			£74	15 0

CHAPTER III

RETURN OF TOTAL INCOME

Difficulty is sometimes experienced by the taxpayer in completing his annual statement of total income.

Income Tax may be charged in one of two ways :—

(*a*) By direct assessment on the person entitled to the income ; or

(*b*) By deduction of tax at the source by the person paying the income ; the latter accounts to the Revenue for the tax deducted as provided for in the Acts and the recipient of the income is entitled to receive a voucher certifying that the income has been paid under deduc tion for tax. Such income is, of course, not liable to Income Tax again in the hands of the recipient. On the other hand, as Income Tax deducted in such cases is always deducted with reference to the full standard rate of tax, the recipient of the Income may have suffered more tax by deduction than he is liable to pay in accordance with his total income and he may have the excess set off against tax payable by him in direct assessments or, if he is not directly assessed, he may claim to have the excess repaid.

The commonest form of income so received is that derived from shares in Limited Companies. The company pays tax on the whole of its profits before any distribution is made by way of dividend to the shareholder, and when

the distribution of profits is made the dividends are paid to individual shareholders under deduction for tax, the company so recouping itself for the tax which has been paid on the distributed profits.

The amounts to be included in the Return Form under the various sections are the amounts calculated in accordance with the legal basis of assessment as defined for the particular Schedule or part of a Schedule within which the source of income falls to be assessed. These bases will be dealt with in the course of explaining the Schedules themselves, e.g.—

If an individual *owns* property, land, buildings, &c. (Schedule A), the amount to be returned is the net Schedule A assessment of the property owned. (Net Schedule A is the Schedule "A" Assessment as reduced by the allowance for repairs, and in Scotland the allowance for owners' rates.)

If an individual *occupies* land (Schedule B) the amount to be included in the return is the "assessable value."

If an individual is in receipt of untaxed interest (e.g. War Loan or Bank Deposit Interest) the amount to be returned is normally the amount of interest received in the year preceding the year of assessment.

Directions are given on the form for calculating the amount of income to be included.

Income received under deduction for tax is also to be returned on the form in a statement of total income, although such income has already been subjected to tax at the source. The income will not again be assessed, but the amount is necessary for determination of the total income. The amount to be returned is the gross amount (that is, the net amount plus the tax deducted); in the case of a dividend, &c., paid free of tax an addition will

require to be made to the amount of the dividend received equivalent to the tax paid on the proportion of the profits yielding the net amount of the dividend. A simple arithmetical calculation gives the gross sum required to be returned in such a case, e.g.—

> Suppose a net dividend is received free of tax for the year 1927-28 equal to £80 :—Rate of tax for 1927-28 was 4s. in the £. Twenty shillings is the gross amount which after deduction of tax at 4s. in the £ leaves a net amount of 16s. Therefore,
>
> $$\frac{20\text{s.} \times £80}{16\text{s.}} = £100$$
>
> is the gross amount of dividend which after deduction of tax at 4s. in the £ yields a net dividend of £80, or in other words, multiply by 5 and divide by 4.

The amount of taxed income (that is, income from which tax has been deducted at the source) to be included in a return of total income for any year of assessment is the gross amount receivable in that year. In point of fact, however, it will seldom be known at the date when the return of total income is being completed how much income is actually receivable, so that as a matter of practice it is usual to insert the figure of the previous year. This may be adjusted, if necessary, when the actual amount of income for the year of assessment is known.

Having completed his return of income to the point of including all the various sources, whether liable to direct assessment or not, the taxpayer must proceed to complete the statement of " annual charges."

These " charges " constitute annual payments from which the payer is entitled to deduct Income Tax at the time of payment. The Income Tax Act provides that

where an individual is liable to pay any annual sums being annual interest, or other amounts payable by virtue of an agreement or contract, Income Tax should be deducted from such payments by the payer and the recipient must allow the deduction of tax.

Such "charges" usually comprise, *inter alia*, loan, mortgage or bond interest, ground rent, ground annual, feu-duty, minister's stipend, royalties and patent fees.

Exception is made in the cases of interest on Bank Overdraft and interest paid to a building society under arrangement with the Board of Inland Revenue, where Income Tax is *not* deducted at the time of payment of the interest and tax is, therefore, not recovered by retention in the payer's assessment.

The total of these charges is deducted from the taxpayer's total income for the purpose of ascertaining his "total net statutory income," which is the total income determining his Super Tax liability, if any, and his allowances and reliefs, &c., where these are, to any extent, dependent upon total income (e.g. Life Assurance).

For the year 1928-29 Income Tax Return Forms have been considerably simplified. This has been rendered possible to some extent by the simplification of bases of liability, &c., effected by the Finance Acts of 1926 and 1927.

At the same time an endeavour has been made by the Inland Revenue authorities to ensure that each taxpayer will receive and be required to complete only one form for each year. Hitherto, in cases where a taxpayer had several separate sources of income directly assessable in different districts, e.g. where property was situated, or where remuneration or profits were earned, several forms of return were often served in the course of the same year.

Now a single return form is to be issued from the district of principal direct assessment, such district being the taxpayer's General Claims District. The latter District is responsible for instructing any other Districts concerned with the direct assessment of the taxpayer's liability as to the amount of the liability and the manner in which it is to be charged.

This system of "one man—one return" should serve to obviate irksome duplication of returns and requests for information from the taxpayer, provided, of course, that the latter discharges his obligation in the matter by ensuring that this return form is correctly completed and expeditiously returned.

It should be noted that a return of total income requires to be made on behalf of a Limited Company and a firm (in addition to the partners' individual returns). The form used for this purpose is Form No. 1, and is the same in both cases. The income to be returned on this form must be restricted to the income pertaining to the company or the firm as distinct entities. This will include :—

(*a*) The business profits—the figure to be included is the figure of profit as agreed with the Inspector, i.e. the assessable profits.

(*b*) Property owned by the concern—this will include business premises owned and occupied by the concern in addition to any other property owned.

(*c*) Any other income, e.g. untaxed interest, or income from investments specifically belonging to the concern.

(*d*) A statement of the annual charges payable by the concern.*

*NOTE.—(*b*), (*c*) and (*d*), apart from untaxed income, do not require to be shown by a limited company in its Return.

If an allowance for depreciation (and it should be noted that the allowance in this respect must be claimed each year even where all or any part of the allowance cannot be granted from the assessment on account of loss, &c.) is claimed the amount must be entered in the section provided for the purpose.

In addition to the foregoing the Return Form of a firm must be completed to show the shares of the firm assessment to which the individual partners are respectively entitled. Where a partner is entitled to a salary or interest on capital the amounts of these payable to him *for the year of assessment* must be entered in the Section provided for the allocation of profits among the partners. The basis on which the remainder of the profits falls to be distributed among the partners must also be indicated in the same section.

The following will show the manner in which details of partners' shares are calculated in terms of the assessable profit :—

Assume the agreed figure of profits of the firm A., B. & C. for 1927-28 to be £1,500 and three partners as follows :

A.—entitled to a salary of £300, interest on Capital £50 and share of profits one-half.

B.—entitled to a salary of £200, interest on Capital £40 and share of profits one-third.

C.—entitled to a salary of £100, interest on Capital £30 and share of profits one-sixth.

The section showing the details of partners' shares of profits would appear as follows :—

Name	*Residence*	*Salary*	*Interest on Capital*	*Share of Balance*	*Total*
A.	—	£300	£50	½=£390	£740
B.	—	200	40	⅓= 260	500
C.	—	100	30	⅙= 130	260
		£600	£120	£780	£1,500

It is a generally accepted principle that income, for Income Tax purposes, must be received or receivable in money or capable of being converted into money by the recipient. It follows, therefore, that the value of a rent free residence (e.g. occupied by a manager in virtue of his office) where the occupier has no right to let the residence does not constitute income for Income Tax purposes. Similarly the value of board residence given in return for services rendered is not assessable income.

Further, it should be noted that the following sources of income are not considered to be assessable income :—

(*a*) Disability pensions granted to ex-service men.

(*b*) Sickness benefit.

(*c*) Lump sum paid for compensation for injury or loss of office.

(*d*) Sums, other than annuities, received under Life, Sickness or Accident Insurance Policies.

(*e*) Accumulated interest on War or National Savings Certificates provided that the number held by the

owner does not exceed the number authorised by Treasury regulations. (At present the individual limit is 500.)

(*f*) Scholarships and grants to students for research or similar training at Colleges, Universities, &c., or held by persons receiving full time education at a School, University or other educational establishment.

(*g*) Dividends in respect of purchases received from Industrial, Provident, or Co-operative Societies.

(*h*) Unemployment, sick, and strike pay received from Trade Unions, &c.

(*i*) Competition prizes.

Trusts, Executries, &c.—These bodies, where they are in receipt of income subject to direct assessment, are treated, to all intents and purposes, like corporate bodies and are assessed at the full standard rate without any allowances beyond those normally granted to such bodies, e.g. depreciation, &c. When the trustees pay over the income to the beneficiaries or other persons entitled thereto, they should deduct tax at the full standard rate on the amounts of the payments which are treated as ordinary income, taxed before receipt, in the hands of the recipients.

Children's Income.—Where a child has income *in its own right* liability attaches to this income in the ordinary way. Where the child is a minor and has a legal guardian, the latter is responsible for all matters relating to a return of this income for assessment purposes and payment of the tax thereon. The same person may also claim repayment on behalf of a minor. Where the child has no legal guardian, the former may be assessed in the ordinary way.

Accumulated Interest of Minors.—Where income accumulates to a minor under a Trust, Deed, or other arrangement, and the minor's interest therein is absolute, repayment claims (where necessary) may be made year

by year on his behalf in respect of each year's income, the minor being entitled to the ordinary personal allowance (£135), and reduced rate on the first £225 of taxable income.

Where the interest of the minor is contingent, i.e. dependent upon the happening of some future event, e.g. coming of age, a repayment claim may be made each year in respect of the amount of the income, if any, expended each year on the maintenance and education of the minor. When the contingency happens, a further repayment claim may be made by the individual himself for a revision of the reliefs due to him for each year of the period during which the income accrued prior to the contingency, by reference to the total income of each year of the period. That is to say, there will be calculated the amount of repayment due for each year by reference to the income of each year and the allowances due, and from the total of the repayment due for the whole period, there will be deducted the aggregate amount of the relief already given over that period on claims for maintenance, &c. This final claim may be lodged within six years of the end of the year of assessment in which the contingency happened.

Tax Compounded War Loan.—For Income Tax purposes the amount of tax compounded War Loan interest to be included in a statement of total income is the actual amount of the interest received in the year of assessment. It should be noted that, although this interest requires to be included in a statement of total income, no repayment can be claimed in respect thereof.

Dividend Warrants.—By the Finance Act, 1924, Section 33, every dividend warrant issued by a company must show (*a*) the gross amount of the dividend, and (*b*) the rate and amount of tax deducted, and (*c*) the net amount actually paid.

CHAPTER IV

SCHEDULES

Prior to 1918 Income Tax was levied in accordance with various regulations incorporated in Acts of various dates from 1799 onwards. By 1918 these taxing provisions were so numerous and so diversely distributed through various Acts that the idea was conceived of incorporating the whole of these regulations into one Act. Thus it happens that the Income Tax Act, 1918, is a consolidating Act collating in ordered sequence all the provisions of earlier Acts and regulations. At the same time the 1918 Act contains additions to, and amendments of, some previous enactments.

Any alterations in the taxation statutes since 1918 are incorporated in the Annual Finance Acts subsequent to 1918.

The Acts apply equally to all parts of Great Britain and Northern Ireland except in so far as peculiarities of practice are specifically expressed in the statutes. This follows on the normal practice that a national law cannot receive different constructions in different parts of the Kingdom.

Income Tax Acts, like other Acts, are interpreted strictly according to the meaning of the words in which the enactment is expressed. That is to say, that in construing Revenue Acts it is necessary to give a fair and reasonable construction and not to lean in favour of one side or the

other, on the ground that it is a tax imposed on the subject and therefore ought not to be enforced unless it comes clearly within the words.

The scope of the Income Tax Acts is to establish a comprehensive system of direct taxation having for its object the taxation of income from every source in the United Kingdom accruing to anyone whether resident in the United Kingdom or elsewhere and of income arising outside the United Kingdom accruing to residents in the United Kingdom.

It is a noteworthy fact that while the Income Tax Act, 1918, expresses the rules and regulations under which Income Tax is to be levied and formulates directory rules as to the basis on which the charge is to be made, there is nowhere in the Act an attempted definition of what constitutes " income " for taxation purposes. The omission, of course, is intentional; for, on consideration of the multitude and variety of ways and circumstances in which income may arise, it becomes evident that any definition of income which sought to exhaust all the possible circumstances of its acquirement would have been speedily nullified by exceptions and variations and would only have led to confusion and attempted evasion.

For the purpose of charging to Income Tax, however, income is divided into five categories or Schedules, named alphabetically A, B, C, D and E. The income under these Schedules is distinguished variously according to the source from which it is derived, and charged according to specific rules and bases expressed in each Schedule.

The general charging section of the Act enacts that Income Tax is to be charged on all " Property, profits or gains respectively described or comprised in the Schedules marked A, B, C, D and E . . . and in accordance with the rules respectively applicable to these Schedules."

CHAPTER V

SCHEDULE "A"

The subjects of charge under this Schedule are confined to the *ownership* of property and lands.

The basis of assessment is the "Annual Value" of the subject assessed.

This Schedule embraces ownership of subjects capable of actual occupation, e.g. land, houses, &c. The Annual Value is the conventional income from the subject assessable and practically corresponds with the annual rent of the property. In England the Annual Value coincides with the "rack rent" which in turn is arrived at from a consideration of the letting value of the property on an ordinary tenancy agreement. In Scotland, however, the Annual Value adopted usually coincides with the value adopted under the Lands Valuation Acts for purposes of local rating.

The Annual Value having been ascertained, forms the basis of the gross assessment under Schedule A. From the assessment is deducted an allowance in respect of repairs calculated on a graduated scale according to limiting values as follows :—

From the Annual Value of the Property as assessed, the allowance for repairs is—

(*a*) Where the Annual Value does not exceed £40 .. .. One-quarter.

(*b*) Where the Annual Value exceeds £40 but does not exceed £50	£10
(*c*) Where the Annual Value does not exceed £100	One-fifth.
(*d*) Where the Annual Value exceeds £100	£20 plus one-sixth of the excess of the Annual Value over £100.*

In the case of land the allowance for repairs is a fixed amount equivalent to one-eighth of the assessment.

It is to be noted that in Scotland the owner is liable to certain local rates which in England are borne by the tenant. As a consequence of this there is allowed in Scotland from the gross Schedule A Assessment an amount equivalent to the rates payable on the property by the owner for the year of assessment.

It is also to be noted that the Annual Value is not ascertained anew each year but in certain years, when directed by the Finance Act, all property is re-valued for the purpose of determining the Annual Value. Such a year is called a year of re-valuation and the value of properties adopted for that year remains in force normally for a period of five years. Where structural alterations are effected the Annual Value can, however, be increased during this period.

The assessment on any property will, of course, be discharged, in the event of some or all of the rent for such property being lost by the owner through the absconding of the tenant, proportionately to the amount of the rent lost. Where property is unlet, the assessment is still made, but relief will be given by discharge of tax according

*NOTE.—In the case of rents increased between the years of re-valuation reference should be made to Rule 7 (2), No. 5, Schedule A.

to the period of the year of assessment during which the property remained unoccupied.

Allowance is made in the Act for exemption of certain subjects from tax under Schedule A as follows :—

(*a*) Colleges or halls in any University of the United Kingdom occupied for educational purposes.

(*b*) Buildings belonging to Hospitals, Public Schools or Almshouses in so far as these are used for the ordinary purposes of the concern.

(*c*) Buildings belonging to a literary or scientific institution used solely for the purposes of the institution and where no payment is made or demanded for instruction.

Certain classes of buildings whether rated or not are, by concession, exempted from Income Tax. This concession is granted where it is established that the buildings are not let for profit or that such sums as are received from occasional lettings are only intended to cover cost of cleaning, lighting, &c. Such buildings are :—

(*a*) Council Schools, Denominational Schools, Mission Rooms (though used occasionally for purposes other than educational or religious).

(*b*) Parish Halls and Rooms, Parish Clubs, Church Institutes and Buildings of a similar character almost exclusively used for divine worship, Sunday Schools and other religious objects.

It should, of course, be noted that the term exemption does not extend to cover the tax payable on charges such as ground rent, feu-duty, mortgage or bond interest or other annual payments secured on the property, from which tax is deducted by the payer at the time of payment. In other words tax deducted from charges or burdens must be recovered by the Revenue.

It may be well before passing from Schedule A, which deals, as has been stated, with lands, houses, buildings, &c., *owned*, to point out that the individual who owns his land, house, or other subject assessable under Schedule A, and occupies same himself is assessable thereon on the annual value of the subject in the same way as the owner who has let the subject to tenants.

In fact, of course, the owner occupier has no income from the subject which he occupies himself, but the annual value of the same is reckoned for Income Tax purposes as potential income to him. That is to say, by not having to pay rent for the occupation of the subject, he saves an amount equivalent to the rent which is expressed in the annual value. At first sight this might seem a hardship, but in fact, the annual value represents more or less the yearly *income* value of the capital sunk in the land, building or other subject. Further, as the Income Tax Acts do not extend to tax capital as such, but only the yearly income which arises therefrom, the annual value of the house, &c. owned and occupied is taken as the measure of yearly income arising from the invested capital represented by the structure.

GENERAL

On a strict interpretation of the charging section of Schedule A, tax is to be charged " on all lands, tenements and hereditaments whether occupied at the time of assessment or not." In practice, however, where any house is void, that is, unoccupied and unfurnished (and " house " in this connection covers dwelling houses and other buildings), tax for the period during which it is void will be discharged. The relief does not extend to lands, but here also in practice, where the land is *waste* and *unenclosed*, relief from tax on such land will be granted.

Where the owner of any land or houses proves that the cost to him of *maintenance, repairs, insurance and management* on the average of the expenditure of the *five years preceding* the year of claim has exceeded

(*a*) In the case of lands the one-eighth of the annual value allowed as the statutory deduction for repairs in the assessment on the land, and

(*b*) In the case of houses, the amount which has been allowed in the Schedule A assessments for repairs,

he may claim relief in respect of the excess. The relief which may be claimed is limited by reference to the amount of the net Schedule A assessments on the property embraced by the claim. It is understood that, by Board of Inland Revenue concession, the word "houses" includes all subjects covered by No. 1 of Schedule A.

Expenditure on additions or improvements to farmhouses, farm buildings or cottages made in order to comply with the provisions of any statute, &c., is admissible if no increased rent is charged.

Tax under this Schedule is payable in one instalment except in so far as it is charged on properties treated as earned income.

CHAPTER VI

SCHEDULE "B"

Liability under Schedule B arises out of the *occupation* of any land and is quite independent of the ownership which has already been discussed under Schedule A. Tax under this Schedule is levied in addition to the tax under Schedule A, with the exception that it is specifically provided that liability does not extend to—

(*a*) Structures on the land in the nature of dwelling-houses, except such as one occupied with a farm and utilised for farming ; and

(*b*) Buildings in the nature of warehouses, works and other buildings used for business purposes.

The Act presumes that all land is capable of actual occupation. The only statutory exemption from tax under this Schedule is that provided by the Finance Act, 1921, which excludes from assessment lands occupied by a charity where such lands are—

(*a*) Occupied for the purpose of husbandry ; and

(*b*) The husbandry is mainly carried on by beneficiaries of the charity ; and

(*c*) The profits, if any, arising from the cultivation of the land are applied solely to the purposes of the charity.

(For Income Tax purposes "charity" has a special interpretation, and the reader is referred in this connection to Chapter XVII.)

This exemption governs, *inter alia* :—

(*a*) Public Parks, Recreation Grounds, &c., where held in trust for the public.

(*b*) Lands attached to Hospitals, Public Schools and Almshouses and used for the purposes of these concerns

In practice, however, the exemption is extended to—

(*a*) Gardens and Pleasure Grounds occupied with a house and not exceeding one acre in extent.

(*b*) Public Parks, &c., belonging to municipalities, &c.

(*c*) Allotments, Plots, &c.

(*d*) Waste Lands—in this case the land must be unenclosed.

Tax under Schedule B is levied on the occupier upon a conventional basis termed "the assessable value," which in turn is computed with reference to "the annual value" which forms the basis of assessment under Schedule A. It should be noted, however, that the "assessable value" varies according to the purpose for which the land is occupied.

In the case of land occupied exclusively or mainly for husbandry the "assessable value" is equal to the annual value, inclusive of tithe.

"Assessable value" in the case of lands other than those occupied for husbandry is one-third of the annual value under Schedule A. The following lands may be considered to be occupied for purposes other than husbandry :—

Gardens (other than Market Gardens).

Race Courses.

Golf Links, Football Grounds, Tennis Courts, Bowling Greens, and other lands used exclusively or mainly for sport or recreation.

Pleasure Grounds and Park Lands.
Aerodromes and other land used in connection with a trade.

Broadly speaking "husbandry" may be interpretated as the labouring of lands with a view to the cultivation of crops, or shortly expressed, "the cultivation of anything with a root."* It should be pointed out here that while lands occupied wholly or in part for the purposes of raising cattle are assessable in the ordinary way under this Schedule, the Commissioners have power if they consider that—

(*a*) The land occupied for grazing purposes by a dealer in cattle or milk is insufficient for the upkeep of the cattle, &c., and
(*b*) That the assessable value does not fairly reflect the profits,

to call for a statement of profits and, if necessary, to raise assessments under Schedule D (Case III) for the amount by which the profits exceed the Schedule B assessment.

Where any lands are taken by a tenant or sub-let for a period less than a year, e.g.—for seasonal cattle grazing—the original lessee's liability under Schedule B is maintained and the liability of the grazer who, for Income Tax purposes is not deemed to be the occupier, is dealt with under Schedule D.

Lands occupied as nurseries or market gardens (this does not include hop lands) are assessed under Schedule B, but under the rules of Schedule D.

The taxpayer occupying land for *the purposes of husbandry only* may elect to be assessed under Schedule D instead of Schedule B, in which case the assessment will be made as in the case of trades. Such election must be intimated by notice in writing to the Inspector within two months

*Note.—In a recent case it has been held that husbandry includes an industry which is mainly dependent for its profits upon the fruits of the soil, e.g. certain poultry farms.

after the beginning of the year of assessment for which it is desired that the liability should be assessed under Schedule D. The election holds good for one year only and must, if desired, be renewed. In Scotland, the election is valid if intimated prior to the 5th of August of the year of assessment.

It is also provided that where the actual profits for the year of assessment of lands occupied for husbandry only fall short of the assessment under Schedule B, application may be made by the taxpayer to have the liability under Schedule B reduced to the amount of the profits. For this purpose a statement of profits made up for a year to a date approximate to the 5th of April—i.e. either before or after that date—will be taken as the profits of the year of assessment.*

A person occupying woodlands managed on a commercial basis with a view to the realisation of profits may elect to have such liability assessed as a trade under Schedule D instead of under Schedule B. The terms of election are precisely similar to those obtaining in the case of husbandry. There is this distinction, however, that in the case of woodlands the assessment having been made for any year under Schedule D as the result of election, the liability remains, without further option, under Schedule D in subsequent years so long as the woodlands remain in the occupation of the person making the original application. On a change of occupier, however, the rights of election as above may be re-exercised.

Assessments under Schedule B are considered to be earned income, and the earned income relief will be granted from these assessments to individuals.

Tax under this Schedule is payable in two equal

*See Table of Time Limits at end of chapter on "Claims."

instalments, even although a farm is owned by a limited company.

Although no formal deed of partnership may exist, if it can be proved that a farmer and his son(s) or other person(s) are occupying land on a partnership basis, the assessment may be allocated on the partnership basis.

FARM ACCOUNTS

The conventional basis of assessment under Schedule B (i.e. the assessable value) obviates the necessity of preparing and lodging accurate statements of profits. In all cases, however, where revision of the Schedule B liability is sought with reference to the actual profits, Financial Accounts will require to be lodged in the ordinary way in support of such application.

The following points of importance emerge in the preparation of Farm Accounts.

(*a*) Implements and Loose Tools—the amount which can be charged against profits is the cost of replacements and renewals as and when incurred.

(*b*) Plant and Machinery—an allowance in respect of depreciation may be charged against profits at rates agreed between the Farmers' Union and the Inland Revenue on the capital value of the plant and machinery.

(*c*) Live Stock—this must be re-valued at each balancing date in terms of the cost or market values whichever represent the fairer value.

(*d*) The value of produce for family or private consumption must be credited to revenue, for Income Tax purposes, at cost price.

(*e*) The value of produce allocated to servants or other hired employees is chargeable against the profits at cost price.

(*f*) Crops will require to be valued and a reference should be made to their forwardness or otherwise.

(*g*) Receipts from the sale of poultry, eggs, butter, &c., form part of the revenue of the farm and should be included with other receipts. In many cases such receipts are retained by the farmer's wife without being accounted for.

(*h*) The owner-occupier of a farm is entitled to charge against the profits the Net Schedule A of the farm as an allowance in lieu of rent.

(*i*) The assessable value is presumed to be the measure of profit derived from the cultivation of the lands and sale of the produce, and it is assumed that the capital of the occupier is sufficient for this purpose. Accordingly, where the farmer is paying interest on an overdraft procured for the purpose of carrying on his trade, the profit is considered to be reduced by the amount of interest payable in the year of assessment. Relief may be claimed on the amount of such interest paid, even although no Financial Accounts are lodged.

(*j*) Drainage or other exceptional expenditure cannot be spread over a number of years.

(*k*) Manure or dead stock can be valued at balancing dates at cost or market prices.

The following is an example of Farm Accounts. X. is a farmer, who was assessed 1927-28 under Schedule B as follows :—

			Tax
Assessable Value		£400	
Less : E.I.R.	£67		
P.A.	225		
Ch.	63		
	—	355	
		£45 @ 2/-	£4 10 0
His other income is as follows :—			
£50 War Loan Interest .. (Assessed Case III, Sch. D.)		£50 @ 2/-	5 0 0
Carried forward			£9 10 0

			Tax
Forward			£9 10 0
Schedule A on Farm—			
Annual Value ..	£400		
Less : Repairs ..	50		
	£350		
		*£130 @ 2/-	13 0 0
		£220 @ 4/-	44 0 0
Wife's Income—			
Taxed Dividends £60 gross—Tax deducted			12 0 0
			£78 10 0

*£225 — (£45 Sch. B + £50 Case III, Sch. D.)

At the end of the year he discovers that his profits were less than the assessment, and application is made to have the liability for 1927-28 reduced to the amount of the profits for the year. In support of this claim he lodges accounts with the Inspector as follows :—

TRADING ACCOUNT for year ended 31st March 1928

Dr.	£	*Cr.*	£
To Wages (including 30s. per week to son)	1,500	By Receipts ..	2,970
,, Feeding Stuffs ..	250		
,, Grain for crops ..	670		
,, Hire	35		
,, Replacement of Farm Implements	50		
,, Insurance ..	20		
,, Horses replaced (2 died)	60		
,, Net Profit.. ..	385		
	£2,970		£2,970

His Inspector is prepared to accept the figures. Calculate the amount of tax which X. is entitled to be repaid.

N.B.—All tax for 1927-28*—with the exception of the second instalment of Schedule B Assessment—has been paid at the time of lodging the claim.*

The account, as above, will require to be adjusted, for Income Tax purposes, as follows :—

Profit per Account	£385
Less : Net Schedule A of Farm	350
	£35

NOTE.

(*a*) The amount to be charged in respect of Working Horses, in Farm Accounts, is the amount of the actual cost of replacements during the year.

(*b*) The same remarks apply to Farm Implements and Loose Tools.

(*c*) As X. also *owns* the farm he is entitled to charge against the profits the Net Schedule A as above.

(*d*) The Account is on a cash basis, but where necessary this could be adjusted for opening and closing Debtors and Creditors.

The revised liability would be as follows :—

			Tax
Farm Profits (as adjusted) ..		£35	
Less : E.I.R.	£6		
P.A. (part to cover)	29		
	—	35	
		—	Nil
Case III Assessment		50	
Less : P.A. (part to cover) ..		50	
		—	Nil
Carried forward			Nil

				Tax
Forward				Nil
Schedule A Assessment		£400		
Less : Repairs	£50			
P.A. (Balance of £225)	146			
Ch.	63			
	—	259		
		141 @ 2/–	£14	2 0
Dividends		60 @ 2/–	6	0 0
Tax on total liability (revised) ..			£20	2 0
Total tax—as above (original) ..		£78 10 0		
Less : Unpaid Schedule B second instalment (one-half of £4 10s.)		2 5 0		
			76	5 0
Repayment due of			£56	3 0

It should be pointed out that, for simplicity, all the points in (*a*) to (*k*) beforementioned have been assumed to have received consideration.

CHAPTER VII

SCHEDULE "E"

This Schedule covers :—

(*a*) Remuneration of Employees (this includes Directors' Fees).

(*b*) Pensions, Annuities, &c., payable in respect of past services to retired employees or their representatives.

(*c*) Leave pay, Finance Act, 1923 (Section 17).

Liability under this Schedule arises only in respect of the period during which the office or employment of profit is exercised. If an individual ceases to be employed during the year of assessment or changes his employer, liability will be adjusted according to the period of the year of assessment during which the employment was exercised.*

For years of assessment from 1928-29 inclusive, the basis of assessment is the full amount of remuneration or income for the year preceding the year of assessment and thus the basis of assessment under this Schedule is brought into line with the basis under Schedule "D."

The following subjects of liability are, however, specifically excepted from this basis and remain chargeable on the

*NOTE.—Schedule E assessments can be appealed either to the General or Special Commissioners.

basis in force up to the years 1927-28 inclusive, viz., the actual remuneration of the year of assessment :—

(1) Leave pay.

(2) Offices or employments held or exercised occasionally or intermittently in the United Kingdom by a person who is not actually resident there.

(3) Half-yearly assessments on manual wage earners.

The only deduction allowable from the emoluments, &c., assessable under Schedule "E" are expenses "wholly, exclusively and necessarily" expended in the performance of the duties of the employment and based on the amount incurred in the previous year, the remuneration of which forms the basis of assessment.

The admissibility of expenses as a deduction under Schedule "E" turns altogether on the interpretation of the words "wholly, exclusively and necessarily" incurred in the performance of the duties. Confusion sometimes arises through a failure to distinguish between expenditure incurred *prior to the exercising of the employment* and *during* the employment. For example, an individual may reside at some distance from the place of his employment and travel from his residence to the employment by train. The cost of such travel (e.g., season ticket) is an expenditure incurred *prior* to the commencement of the employment and, therefore, does not come within the scope of the allowance.

Similarly, a taxpayer may exercise two or more employments in different places and require to travel from the one to the other. Again, the cost of such travel is not incidental to the actual performance of the duties of any of those employments, but merely expended to enable the holder of the employments to arrive at the places of employment. On the other hand, a taxpayer who is

employed as a commercial traveller must necessarily move from one place to another in order to fulfil the duties of his employment. In this case such expenditure (which would not include the cost of travel from his residence to the place of his employment unless his residence were made the centre of his ordinary commercial journeys) would be admissible.

" Remuneration " may include any or all of the following :

Salaries.

Fees.

Wages.

Perquisites (being fees or other emoluments arising in the course of exercising the employment),

Bonus.

Commission.

Other emoluments.

Provisions to cover the cases of—

(*a*) The liability in respect of an employment arising for the first time ; and

(*b*) The liability in respect of an employment ceasing within the year of assessment,

operate as follows :—

(*a*) For the year of assessment in which the person first holds the office or employment or is in receipt of income assessable under Schedule " E," the liability is based on the emoluments of that year.

(*b*) Where the income liable under Schedule " E " first arose on a day in the year preceding the year of assessment, other than the 6th day of April, the basis of assessment is the actual amount of the remuneration for the year of assessment.

(*c*) For the first year of assessment for which the preceding year's income is taken as the basis of liability (it may be the second or third year of the office, employment, &c., according to circumstances) the person assessed may claim to have the assessment reduced to the actual remuneration of the year.

(*d*) Where, in any year of assessment, the person ceases to hold an office or employment, or is deprived of the source of the income assessable under Schedule "E," tax will be charged for that year on the amount of the emoluments for the period from the beginning of the year of assessment (viz. 6th April) to the date of cessation.

(*e*) In the case of cessation of the source of the income assessed under Schedule "E," the assessment of the year preceding the year of cessation may be revised by additional assessment, to bring it up to the actual amount of the income of that year, if the latter is greater than the amount of the assessment.

In the case of a person dying, and where an adjustment in accordance with paragraph (*e*) above falls to be made, the executors or administrators of the deceased become chargeable in respect of such adjustment, and the tax thereon is deemed to be a debt due from, and payable out of, the deceased's estate.

For years to 1927-28 inclusive, as stated above, the basis of assessment was the amount of the remuneration payable in respect of the employment for the year of assessment, subject to a deduction from the gross amount of such remuneration of any sums allowable as expenses. Adjustments of assessed liability were, therefore, necessary to give effect to increases or decreases of remuneration or income taking effect during the year of assessment.

Although, strictly speaking, the legal basis of assessment under Schedule "E" for years 1927-28 inclusive, was the total amount of remuneration, &c., of the year of assessment, for convenience in those cases where the remuneration consisted wholly or in part of fluctuating emoluments (e.g. commission, bonus, &c., calculated with reference to turnover or some other basis), the Revenue authorities might arrange to adopt the amount of such commission received in the year preceding the year of assessment as the basis for the year of assessment. It should be noted particularly that this concessionary arrangement extended only to such part of the remuneration as was calculated on a fluctuating basis.

A position peculiar to Schedule "E" may arise in connection with liabilities under that Schedule. In some cases, particularly with limited companies, the tax on employees' remuneration is paid, not by the employees, but by the employer (e.g. on directors' fees and salaries of bank officials). For Income Tax purposes, the amount of tax paid by the employer on behalf of an employee is treated as additional remuneration payable to the latter.

In practice (except where in the first year of employment the actual remuneration of the year forms the basis of assessment) the gross amount of the employee's Schedule "E" assessment is arrived at by adding to the amount of the remuneration of the previous year the amount of tax payable on his behalf for that year. The following example will illustrate the principle as regards the first years when it is necessary, in order to arrive at the gross amount of the remuneration for assessment, to calculate a sum which, after deduction of the tax payable thereon, taking into account the allowances and reliefs to which the employee is entitled, will leave a sum equivalent to the actual amount of the remuneration received by the employee :—

An employee in the first year in which tax is paid on his behalf has a salary of £550 for 1927-28 and Income Tax is paid on his behalf by his employer. He is entitled to a personal allowance of £225.

Let x be the amount of tax chargeable :

$\therefore$ The gross assessment is $£550 + x$

$\therefore$ The assessable income is $\frac{5}{6}(550 + x)$

$\therefore$ Taxable income is $\frac{5}{6}(550 + x) - 225$

$$= 233\tfrac{1}{3} + \frac{5x}{6}$$

$\therefore$ Tax on $233\frac{1}{3} + \frac{5x}{6}$ is 225 @ 2s. + $\left(8\frac{1}{3} + \frac{5x}{6}\right)$ @ 4s.

$$x = \left(225 \times \frac{1}{10}\right) + \left(\frac{25}{3} + \frac{5x}{6}\right)\frac{1}{5}$$

$$= \left(225 \times \frac{1}{10}\right) + \left(\frac{50 + 5x}{6}\right)\frac{1}{5}$$

$$= \frac{225}{10} + \frac{50 + 5x}{30}$$

Multiply both sides by 30 :

$$30x = 675 + 50 + 5x$$

$$25x = 725$$

$$x = £29$$

$\therefore$ Gross Assessment is $£550 + 29 = £579$

The above method of calculation remains the same for all cases of this nature for the first year of employment where tax is paid on behalf of the employee.

In order that the change over from the actual to the preceding year's basis may not operate harshly in the case of those taxpayers whose actual remuneration for 1928-29 may be less than the remuneration of the year 1927-28

(which, under the new procedure, forms the basis of computation of the 1928-29 assessment), a relief provision has been devised, which operates as follows :—(It should be noted that the relief can be claimed only by those persons who were actually assessed and charged under Schedule " E " for 1927-28 on the amount of the emoluments of that year.)

If the actual amount of the emoluments of the year 1928-29 is less than the amount of the preceding year, claim may be made to have the 1928-29 assessment reduced to the actual remuneration of that year.

Such claim must be made in writing to the Inspector, not later than 30th June 1929.

Where such a claim is made, and the assessment for 1928-29 is reduced accordingly, the taxpayer concerned *must accept* as the basis of assessment for the succeeding year, 1929-30, the actual remuneration of that year.

From 1930-31 the legal basis (viz. the emoluments of the preceding year) applies without any right of adjustment.

Where an employee pays a contribution to a Superannuation Fund which has received the approval of the Board of Inland Revenue, the amount of the ordinary annual payment will be allowed as " expenses." It should be noted that expenses under Schedule " E " are given as a deduction from the gross amount of the assessment, and the amount on which earned income relief is allowable is the net amount after deduction of the expenses.

From 1928-29 onwards relief in respect of an error or mistake arising in regard to tax charged under Schedule " E " may be claimed under the same provisions as apply to claims in respect of errors or mistakes regarding tax

charged under Schedule "D." This claim is made under the provisions of Section 24, Finance Act, 1923, and is described in the Chapter headed "Claims."

The following examples illustrate the application of the principles of assessment under Schedule "E."

EXAMPLE I

A. is a commercial traveller whose return of total income for 1927-28 contains the following particulars :—

(*a*) Claims to be assessed on the average as follows :—

Year ended 31st March 1925	£240
,, ,, 31st March 1926	280
,, ,, 31st March 1927	320
	£840 Aver.
	£280

(*b*) Expenses :—

(1) Year ended 31st March 1927	£61
(2) Season Ticket	25

(*c*) Other Income :—

5 per cent. War Loan Interest	£15
Net Annual Value of Residence	40

(*d*) Following allowances claimed :—

(1) Wife.

(2) Three children (under 16).

(*e*) Charges : Ground Rent £5.

Employer's return for 1927-28 shows :—

A. Commission paid for year ended 31st March 1927 £320 and value of Season Ticket £25.

NOTES.

(*a*) Average under Schedule E not admissible and remuneration being wholly commission is, by arrangement, assessable on the amount received in the previous year, viz. £320.

(*b*) Value of Season Ticket is not assessable—not being convertible into money—at the same time no allowance as claimed for Season Ticket is made.

His liability for 1927-28 will be as follows :—

Schedule E—				*Tax*
Assessment			£320	
Less : Expenses			61	
			£259	
Less : E.I.R.	£43			
P.A. (part to cover)	216			
	—		259	
			—	Nil
Other liability as follows :—				
Case 3, War Loan Interest ..			£15	
Less : P.A. (balance)	£9			
Ch. (part to cover)	6			
	—		15	
			—	Nil
Schedule A—				
Net Annual Value			£40	
Less : Charges (to cover ground rent)			5 @ 4/–	£1 0 0
			£35	
Less : Ch. (part to cover) ..			35	
				£1 0 0

It should be noted that the only tax payable by A. is on charges to cover the tax deducted by him at the time of payment of the ground rent.

EXAMPLE II

B. is a school teacher whose Return for 1928-29 shows the following :—

Salary	£500
Evening School fees (cannot say till end of year)	
Expenses claimed—Books	10
Other income—Property (net)	50

Allowances claimed :

(*a*) Wife and one child (over 16 but still at school).

(*b*) Life Assurance dated 26th May 1923, £100—premium £9 2s.

Charges on Income :

Ground Rent, £5.

Interest paid in full to Building Society, £20.

The Employers' Return shows the following :—

B.—Salary paid for year to 31st March 1928 ..	£500
Evening School fees for session 1927-28 ..	50

NOTES.

(*a*) Expenses for books not allowable.

(*b*) Evening School fees earned in 1927-28 will be included in the 1928-29 assessment. If the appointment is not held during session 1928-29 the assessment will be reduced accordingly.

(*c*) Allowance for Life Assurance will be restricted to £7, being 7 per cent. of the capital sum assured.

(*d*) The interest paid to the Building Society will be allowed as a deduction. The Society being under arrangement with the Board of Inland Revenue accounts for the tax on the interest it receives.

Liability for 1928-29 will be as follows :—

Schedule E—							*Tax*		
Salary			£500						
Less : E.I.R.	£84								
P.A.	225								
Ch.	60								
	—	369							
		131 @ 2/-		£13	2	0			
Less : L.A. ..		7 @ 2/		0	14	0			
							£12	8	0

Schedule A—								
Net Annual Value		£50						
Less : Charges (to cover ground rent)		5 @ 4/-	£1	0	0			
		45						
Less : Building Society Interest		20						
		25 @ 2/-	2	10	0			
						3	10	0
						£15	18	0

EXAMPLE III

C. is an Inspector of Police and his Return for 1928-29 is as follows :—

(*a*) Remuneration for year to 31st March 1928 .. £800
(*b*) Taxed Dividends (gross) 150
Allowances claimed : Wife.

Employers' return shows the following :

C.—Salary for year to 31st March 1928 .. .. £800
Value of Uniform, House & Coal estimated at 60

NOTES.

(*a*) The value of uniform, &c., £60, is not assessable to Income Tax.

Liability for 1928-29 will be as follows :— *Tax*

Schedule E—

Remuneration ..		£800			
Less : E.I.R.	£134				
P.A.	225				
	—	359			
		£441			
£225 @ 2/-			£22	10	0
216 @ 4/-			43	4	0
					£65 14 0

It should be noted that no relief is due in respect of the tax deducted from dividends as C. has had the full £225 at the half-standard rate in his direct assessment.

At 5th April 1929 C. discovers that his actual remuneration for 1928-29 was £750 and makes application before 30th June 1929 to have the 1928-29 liability revised accordingly, i.e. reduced from £800 to £750.

For 1929-30 C.'s assessment will be raised in the sum of £750 but if after 5th April 1930 it was found that C.'s actual remuneration for 1929-30 was £850, an additional assessment of £100 would be raised to revise the original liability (£750) to this sum. The acceptance of this additional liability by C. is obligatory in terms of his claim to be assessed on the actual remuneration of both 1928-29 and 1929-30.

If, on the other hand, the actual remuneration of 1929-30 is £700, instead of £750 as assessed, a reduction of the assessment to £700 would be made.

For 1930-31 the basis of assessment is the actual remuneration of 1929-30, without any right to revision.

EXAMPLE IV

D. is a managing director, appointed 30th June 1928. His Returns show the following :—

1928-29—(*a*)	Salary and Fees	£1,500
(*b*)	Taxed Dividends (Gross) ..	2,000
1929-30—(*a*)	Salary and Fees	2,000
(*b*)	Taxed Dividends (Gross) ..	2,000
1930-31—(*a*)	Salary and Fees	2,000
(*b*)	Taxed Dividends (Gross) ..	2,000

Allowances claimed :—

(*a*) Wife.
(*b*) Child under 16.
(*c*) Life Assurance—
  (1) Policy dated 26th May 1914 for £1,000—premium £80.
  (2) Policy dated 30th June 1915 for £200—premium £10.

Employers' Return shows the following :—

D.—

Salary and Fees as Managing Director to 31st March 1929—Tax payable by Company ..	£1,500
Salary and Fees as Managing Director to 31st March 1930—Tax payable by Company ..	2,000
Salary and Fees as Managing Director to 31st March 1931—Tax payable by Company ..	2,000

NOTES.

(*a*) Earned income relief will be restricted to the maximum allowance, viz. £250.

(*b*) The allowance for Life Assurance Policy (1) will be restricted to 7 per cent. of the capital sum, viz. £70. The appropriate rate will be 4s.—the total income being in excess of £2,000 and both policies being pre-June 1916.

(*c*) For the year 1928-29, the first year of the appointment, the basis of assessment is the actual remuneration and this requires to be grossified to include tax which is paid on D.'s behalf by the Company.

For the year 1929-30—the first complete year—the basis of assessment is again the actual remuneration which also requires to be grossified to include Income Tax.

For the year 1930-31 the basis of liability is the preceding year's remuneration and to this there requires to be added the tax payable on D.'s behalf for the previous year, viz. £318 2s. 6d. (see below).

Liability: 1928-29

Let x be the tax payable:

$\therefore$ Gross assessment is £1,500 + x

$\therefore$ Assessable income is (1,500 + x) — 250 (Maximum E.I.R.)

$\therefore$ Taxable income is (1,500 + x) — 250 — 225 (P.A.) — 60 (Ch.)

$= 1{,}500 + x - 535$

$= 965 + x$

Tax thereon = 225 @ 2s. + (740 + x) @ 4s.

Tax due = (225 @ 2s. + (740 + x) @ 4s.) — L.A. 80 @ 4s.

$\therefore x = (225 \times \frac{1}{10}) + (740 + x) \times \frac{1}{5} - 80 \times \frac{1}{5}$

Multiply both sides by 10:

$\therefore 10x = 225 + 2(740 + x) - 160$

$\therefore 10x = 225 + 1{,}480 + 2x - 160$

$\therefore 8x = 1{,}545$

$\therefore x =$ £193 2s. 6d.

$\therefore$ Gross assessment = £1,500 + £193 2s. 6d.

= £1,693 2s. 6d.

Liability : 1929-30

Let x be the amount of tax payable :

$\therefore$ Gross assessment is £2,000 + x

$\therefore$ Assessable income is 2,000 + x — 250 (Maximum E.I.R.)

$\therefore$ Taxable income is (2,000 + x) — 250 — 225 P.A. — 60 (Ch.)

= 2,000 + x — 250 — 225 — 60

= 1,465 + x

Tax thereon = 225 @ 2s. + (1,240 + x) @ 4s.

Tax due = (225 @ 2s. + (1,240 + x) @ 4s.) — L.A. 80 @ 4s.

$\therefore x = 225 \times \frac{1}{10} + (1{,}240 + x) \times \frac{1}{5} - 80 \times \frac{1}{5}$

Multiple both sides by 10 :

$\therefore 10x = 225 - 2\ (1{,}240 - x) - 160$

$\therefore 8x = 2{,}545$

$\therefore x =$ £318 2s. 6d.

$\therefore$ Gross assessment = £2,000 + £318 2s. 6d.

= £2,318 2s. 6d.

Liability will be as follows :—

1928-29

Schedule E—

Gross remuneration (to include tax) ..			£1,693	
Less : E.I.R.	£250			
P.A.	225			
Ch.	60			
	—	535		
		1,158		
			Tax	
	£225 @ 2s.		£22 10	0
	£933@ 4s.		£186 12	0
			209 2	0
Less : L.A., £80 @ 4s.			16 0	0
			£193 2	0

1929-30			*Tax*
Schedule E—			
Gross remuneration (to include tax) ..		£2,318	
Less : E.I.R.	£250		
P.A.	225		
Ch.	60		
	—	535	
		£1,783	
	£225 @ 2s.		£22 10 0
	1,558 @ 4s.		311 12 0
			334 2 0
Less : L.A., £80 @ 4s.			16 0 0
			£318 2 0

1930-31	
Schedule E—	
Gross assessment—remuneration	£2,000
Add : Tax payable for previous year ..	318
	£2,318

The liability will work out as for 1929-30.

EXAMPLE V

E. is an insurance inspector, whose remuneration is as follows :—

Year to 5th April 1928	£550
,, ,, ,, 1929	600
Period 6th April 1929 to 30th September 1929 (when he died)	320

The assessments would be as follows :—

1928-29—Based on the income of the preceding year	550
1929-30—Based on the income of the preceding year	600

In view of the cessation of the office by the death of E. at 30th September 1929, the assessment for 1929-30 will be reduced from £600 to £320, the actual remuneration of the period of the year during which the office was held.

At the same time the assessment for 1928-29 requires to be revised from £550 to £600, the actual remuneration of that year.

CHAPTER VIII

SCHEDULE "D"

Schedule D is by far the most important Schedule of the Income Tax Act, covering, as it does, the annual profits or gains arising from trades and professions, interest, annuities and other annual profits or gains not charged under any other Schedule and not specifically exempted from tax. The income chargeable under this Schedule is classified in different categories called "Cases," six in number.

For the Income Tax years to 1926-27, inclusive, each case of Schedule D had its own particular rules and regulations governing the basis of assessment. From 1927-28, however, a universal basis of assessment applies to all cases of Schedule D, except Case VI. This basis is the income of the year preceding the year of assessment.

Special provisions operate to meet the cases of—

(*a*) Trades, &c., set up or commenced and other sources of income or additions to any source of such income acquired within the year of assessment.

(*b*) Trades, &c., discontinued and other sources of income ceasing within the year of assessment.

(*c*) Trades, &c., transferred by sale, &c., during the year of assessment.

These will be commented on in the course of dealing with the separate cases comprising Schedule D.

Cases I and II are in turn the most important of the six cases and the discussion of these will be postponed until the other cases have been dealt with.

CHAPTER IX

SCHEDULE "D"

Cases III, IV, V and VI

CASE III

In addition to untaxed interest, which forms the principal subject of assessment under this case, the following other types of income are assessable within this case :—

(*a*) Surplus profits of dealers in cattle, &c., referred to under Schedule B.

(*b*) Various minor and comparatively unimportant sources of income arising from the ownership of land. Some of the sources expressly mentioned in the Act are seldom met with in practice. The most important of such sources are :—

The tithes arising from land if the payment is made in kind, composition for tithes or payments in lieu of tithes ; teinds (the Scottish equivalent of tithes) ; profits of manors, comprising those payable by tenants on admission or on certain occasions established by custom ; fines or payments made to a landlord by a tenant for the privilege of renewing tenure or leases ; and, generally speaking, all other profits arising from land not in the actual occupation of the person entitled to the payment.

Down to and including the year 1926-27, income of the nature specified in paragraph (*b*) above was assessable under No. 2 of Schedule A, Income Tax Act, 1918, on bases which varied with the specific nature of the income. Such deductions from the income as were allowable when the latter was assessable under No. 2 of Schedule A continue to be allowable for assessment purposes under Case III, Schedule D.

The remainder of the subjects liable under Case III are in the nature of interest. It is important to note, however, that a distinction must be made between the various items of interest according to their sources, that is to say, the nature of the capital from which the interest arises. Before liability in respect of the interest arises, the source of the income must exist in the year of assessment. The various sources from which interest assessable under this case may arise comprise the following :—

War Loan or other Government securities the interest on which is paid in full (i.e. without deduction of tax).*

Interest received or credited in full.

This may arise in a variety of ways (e.g. Interest on a temporary loan, interest on bank deposits, &c.).

Discounts (e.g. on Treasury Bills, &c.).

Income from each source constitutes a separate liability, and in this connection it should be noted that the possession of sources by husband and wife (separately) creates independent liability in respect of each source. This means that while the husband remains liable to be assessed for the wife's income, any interest arising from a source assessable under Case III and possessed by the wife is considered independently for the purpose of arriving at the assessable amount of the interest and of reliefs which may arise in consequence of the cessation of the source.

*Note.—Each type of Government Security is considered a separate source of income.

The normal basis of assessment is the amount of interest received in the year preceding the year of assessment. For the year in which the income first arises the actual amount of interest received requires to be taken as the amount of the assessment, there being no "preceding year's" income. For the second year in which the income arises the amount to be taken for assessment purposes will again be the actual amount of interest received in the year of assessment, unless the source of the income was acquired at 6th April of the year preceding the year of assessment, or, in other words, unless the source was in existence during the *whole* of the year preceding the year of assessment. For the third and subsequent years, as the source has been in existence for a full Income Tax year preceding the year of assessment and as, therefore, a full preceding year's income will be known, the basis of assessment will be, as already stated, the amount of the preceding year's income.

For the first year in which the income of the preceding year is taken as the basis of assessment (which may, as explained above, be either the second or third year of liability) the taxpayer is entitled on application to have the assessed liability for this year revised to the actual amount of the income received in that year. No such relief is competent (apart from cessation of the source) for any subsequent year.

The provisions in force with regard to the commencement or discontinuance of a trade apply to the acquisition or cessation of sources of income assessable under this case, or under Cases IV or V.

The unit of assessment under this case, and also under Cases IV and V, is further distinguished to allow of the treatment as a separate subject of (*a*) any new source of income under any of these cases, or (*b*) any increase or diminution of any particular source.

By the provisions of the Finance Act, 1926 (Section 30), which take effect from 1927-28, profits or income assessable under (*a*) Case III, Schedule D, or (*b*) Case IV, Schedule D, or (*c*) Case V, Schedule D, may be assessed and charged in one sum. At the same time for purposes of

(*a*) the calculation of the assessable amounts of income from the respective sources ;

(*b*) the application of the provisions for assessment of new or increased sources ;

(*c*) the application of the provisions for adjustment in the cases of sources ceased or diminished ;

each source, or part of a source, increased or diminished, is to be treated as a separate unit for assessment purposes.

The net effect of these provisions is as follows :—

(1) The aggregate income arising under Cases III, IV, and V of Schedule D may, after computation of the assessable amounts, be assessed in one sum.

(2) If a new source arises, or if any particular source of income assessable under these cases is increased, during the year of assessment, the income in respect of the new or increased source is to be separately computed and becomes subject to the rules governing the assessment of a source arising for the first time.

These provisions have already been outlined above.

(3) If any source ceases, or if any particular source of income assessable under these cases is diminished, the income from that source or part of a source is to be computed separately, and the provisions applicable to the discontinuance of a trade apply in such cases.

Uuder these latter provisions (to be explained later in connection with trades), the income of the source or part of a source is revised to the actual income of the year of discontinuance or diminution of the source, and the

liability of that source for the previous year of assessment may be increased, but not reduced, to the actual income of that year.

Where income arising and assessable under Case IV or Case V of Schedule D and previously paid without deduction for Income Tax, becomes payable under deduction for tax, the rules applicable to the cessation of a source of income take effect as from the date of change in the method of payment. Conversely, where income arising under Case IV or Case V of Schedule D, previously paid under deduction for tax, becomes payable in full and assessable under these cases, the rules applicable to the assessment of a new source take effect, the source being regarded as new from the date of the change in the method of payment of the income.

The following examples will illustrate the application of the principles governing Case III liabilities :—

EXAMPLE I

A. buys £2,000 5 per cent. War Loan on 2nd June 1925—

Interest received year ended 5th April 1926 ..	£50
Interest received year ended 5th April 1927 ..	100

Liability for 1925-26 .. .. £50

First year in which income arose and liability, therefore, on the actual amount of the year.

Liability for 1926-27 .. .. £100

Second year, but source not in existence for full preceding year, and, therefore, liability on the actual amount of the year.

Liability for 1927-28 .. .. £100

Source in existence during the whole of the preceding year, and liability, therefore, on the income of the preceding year.

But suppose that on 2nd June 1927 A. sold £1,000 of the £2,000 holding of War Loan, the following relief for the year 1927-28 (i.e. for the first year for which the liability is based on the income of the preceding year) may be claimed :

Liability as assessed	£100
Reducible to	75

Being the actual amount of interest received in the year 1927-28, viz.

1st June 1927 ..	£50	Being half year's interest on £2,000 holding ; and
1st Dec. 1927 ..	£25	Being half year's interest on reduced holding of £1,000 from 1st June 1927.
	£75	

NOTE.

The liability for 1928-29 would be £50, the amount of interest received in the preceding year of assessment, from the holding still held, viz. £1,000.

EXAMPLE II

B. is in possession of a holding of War Loan of £1,000 acquired in 1918, and his wife also has a holding of £1,000 acquired in 1922. On 1st June 1928 B.'s wife realises her holding.

Liability for 1927-28 would be as follows :—

(*a*) Interest on B.'s holding—amount received in year 1926-27	£50
(*b*) Interest on wife's holding—amount received in year 1926-27	£50
	£100

Liability for 1928-29 would also be on £100, but in view of the fact that B.'s wife's holding was realised 1st June 1928 the 1928-29 liability could be adjusted to the following figure :—

(*a*) Interest received on B.'s holding as before ..	£50
(*b*) Interest received on wife's holding—actual amount in year 1928-29, viz. half-year's interest received 1st June 1928	£25
	£75

Liability for 1929-30 will be £50, the amount of interest on B.'s holding for the year preceding the year of assessment. There will be no liability for this year in respect of the wife's interest as the source is non-existent.

Where the taxpayer has interest arising from two or more sources within different categories of Case III (e.g from Bank Deposit and War Loan) the method adopted in arriving at the liability and in calculating reliefs due to diminution or cessation of one or other source is precisely the same as that outlined above in the example of husband's and wife's interests.

CASES IV, V & VI

Case IV.—Liability under this case arises in respect of the income from securities outside the United Kingdom, commonly called foreign securities. It must be remembered that in this connection *outside the United Kingdom* includes British Dominions, and, of course, the Irish Free State. For practical purposes, income from "securities" may be defined as income which arises by

virtue of a deed or contract, e.g. from a mortgage, bond, or similar instrument. It should be noted that shares in a company do not come within the definition of "securities."

From 1927-28, inclusive, the basis of assessment is the full amount of the income *arising* in the year preceding the year of assessment subject to special provisions explained below governing the cases of—

(*a*) Persons not domiciled in the United Kingdom ; or

(*b*) British subjects not ordinarily resident in the United Kingdom ; or

(*c*) Income arising from securities forming part of the investments of the foreign life assurance fund of an assurance company.

In these cases the income "arising" is equivalent to the full amount of the sums "received" in the United Kingdom, without any deductions whatsoever. With reference to the expressions "domiciled" and "not ordinarily resident in the United Kingdom" the following observations may be made :—

The question of domicile is one of intricate legal importance, but for practical purposes it may be defined as the country where an individual has his permanent home. This country remains his domicile even if he be absent therefrom, so long as he has not abandoned all intention of returning thereto. A person can only have one domicile, but may have more than one residence. At the same time a person can change his domicile by acquiring another. This is usually done by some overt act, e.g. the taking out of naturalisation papers. A wife acquires the domicile of her husband, a child that of its father.

A person is ordinarily resident in the United Kingdom when as a matter of fact he spends the greater part of

his time there. The subject of residence is dealt with in a subsequent chapter and the student is referred thereto.

The normal basis of assessment under this case has regard, as has been stated, to the full amount of the income *arising* in the year preceding the year of assessment. For this purpose it should be noted that the amount "arising" will include both the income retained abroad and the income, if any, remitted elsewhere. From the gross amount of the income arising, deductions may be claimed from the income not received in the United Kingdom such as might be claimed if the income had been received in the United Kingdom. For this purpose the deductions may include, *inter alia*, allowance for the following :—

(*a*) Income Tax in the place where the income arose. It must be remembered that this is subject to qualification where the place of origin of the income is a British Dominion in which reciprocal relief for British Income Tax is granted. (See Chapter on "Dominion Income Tax.")

(*b*) Annual interest, annuities or other annual payments payable out of the income to persons not resident in the United Kingdom.

The provisions for the assessment of (*a*) a new source, (*b*) increase of a source, (*c*) cessation or diminution of a source are as outlined in connection with liabilities under Case III.

Case V —Liability under this case arises in respect of income from foreign possessions. For Income Tax purposes a " foreign possession " is held to be any source outside the United Kingdom which yields income—foreign and colonial securities, of course, excepted, these being specifically provided for in Case IV. The term, it will be seen, is capable of a wide interpretation, and will include income from such sources as the following :—

(*a*) Rents from property abroad.

(*b*) The profits of a business abroad where the control of the business is situated abroad.

(*c*) Dividends from foreign or Colonial companies.

(*d*) Interest, &c., from Deposits and Banking Accounts abroad.

A distinction is made in computing the liability under this case between income from (*a*) stocks, shares and rents, and (*b*) income from sources other than (*a*).

In the case of (*a*) the basis of liability is the income of the year preceding the year of assessment. The amount of the profits or income to be included for assessment purposes in respect of income arising under (*a*) is the amount of the income whether received in the United Kingdom or not, with deductions in the case of income not received in the United Kingdom similar to those explained in connection with Case IV. Further, where the income falling within (*a*) accrues to persons not domiciled in the United Kingdom or to British subjects not ordinarily resident in the United Kingdom the income is computed on the actual amounts received in the United Kingdom from remittances. (But see Chapter on "Residence.") For Income Tax purposes, income is considered to be "remitted" not only when it is received in the United Kingdom in actual money but also when it is imported or brought into the country in cash, goods or credit values.

Liability in respect of (*b*) is computed on the income of the year preceding the year of assessment. In this case, however, the amount of income to be taken for assessment purposes is the actual sums received in the United Kingdom from remittances payable in the United Kingdom—remittances, in this connection, receiving an interpretation similar to that explained in connection with (*a*) above.

The provisions for the assessment of (*a*) a new source, (*b*) increase of a source, (*c*) cessation or diminution of a source are as outlined in connection with liabilities under Case III.

Case VI.—Liability under this case arises in respect of annual profits and gains which are not specifically directed to be taxed under any other Schedule or Case of the Income Tax Act. The scope of the case is, therefore, extremely wide and it is under this case that the Revenue Authorities seek to assess the income to which they consider liability attaches, and which they are unable to bring within the charging sections of the other Schedules. The question whether liability to Income Tax under this case actually arises must be decided on a consideration of the facts and circumstances relating to the acquisition of the profits. In many cases profits are actually made under circumstances which do not render them liable to Income Tax. Profits of this kind would be the gains arising on the sale of investments (except in the case of financial companies) which are really in the nature of capital accretions, competition prize money, &c.; or profits realised on isolated transactions where the intervals of time between such transactions are sufficiently long to discredit any attempt to interpret these as arising in the course of a trade, vocation, &c.

While it is obvious that the profits assessable under this case may arise in a variety of ways, the commonest examples of such profits are :—

(*a*) Profits from letting furnished houses (except where the profits arise from the ordinary business of boarding-house keeping which is a liability under Case I).

(*b*) Profits from occasional sales or other activities in circumstances which render them liable to assessment.

(*c*) Profits from the sale of patents, rights, literary copyrights, &c., where these do not arise in the course of the recipient's ordinary vocation.

In view of the fact that the assessment of "furnished profits" (the profits arising from letting) constitutes a common type of liability the following information in this connection may be useful.

Income from this source is usually conceded to be earned income where the letting is made inclusive of services.

In arriving at the amount of assessable profits allowance may be claimed for the following (but only the proportion applicable to the period of the let) :—

(*a*) Rent of the house, or proportion where only part is let
(*b*) Local Rates.
(*c*) Cost of heating, lighting and cleaning.
(*d*) Servants' wages, or proportion where services divided.
(*e*) Insurance.
(*f*) Depreciation of furniture—usual rate allowed is 10 per cent.
(*g*) Repairs.
(*h*) Agents' Fees and advertising charges.

It should be noted that where a person vacates his own residence and takes another for the purpose of enabling him to let the former, he is not entitled to charge against the profit from letting, the rent of the house which he himself occupies.

The basis of assessment under Case VI is left to the discretion of the Commissioners, and may be computed with reference to the actual profits of the year of assessment or of the preceding year. Prior to 1927-28 an average based on a period greater or less than a year could be applied.

In practice, however, it is usual to assess under this case on the basis of the actual profits of the year of assessment. A person assessed in respect of an activity under Case VI may, whether he was engaged therein solely or in partnership, if a loss for any year is incurred in this connection,

set off such loss against the profits of the same or any similar activity assessable under this case during the normal period available for the carry forward of losses. This is explained in the chapter headed "Basis of Assessment."

CHAPTER X

SCHEDULE "D"—*Continued*

CASES I & II

Cases I and II may conveniently be combined, for practical purposes, because the distinction between the two cases is almost entirely confined to a differentiation between the profits arising from trades and those arising from professions and vocations. The rules governing the basis of assessment and the deductions admissible in arriving at assessable profits are the same for both cases, but it should be noted that the rule relative to the setting off of a loss in one trade against the profits of another confines this allowance to trades, i.e. to subjects of liability under Case I. Consequently this means that no claim can be made to set off the loss of a trade against the profits of a profession or *vice versa*.

In the study of Cases I and II one is confronted with most of the difficulties of Income Tax—legal, practical and technical. In order to avoid frequent digression for the explanation of important terms or expressions which arise in the study of these cases, it has been thought advisable to devote separate chapters to the development of the principal aspects of these cases.

A consideration of the charging section of Schedule D will show that liability arises under Cases I and II in respect of

(*a*) The profits of a *trade* (Case I) ; and

(*b*) The profits of a *profession* or vocation (Case II).

Where the trade or profession is carried on in the United Kingdom, the profits arising therefrom are assessable on the person(s) (including firms and companies) entitled thereto, whether the latter reside in the United Kingdom or elsewhere. Similarly, where the trade is carried on abroad and controlled by persons residing in this country the profits are assessable under Case I. On the other hand, where the profits arise to a resident in the United Kingdom from a trade carried on abroad in circumstances such that the control of the trade is situated abroad, liability in respect of the profits arises not under Case I, but under Case V, as the income from a foreign possession in the hands of the recipient. The question of whether or not the control of a business abroad is situated in the United Kingdom or elsewhere will be dealt with in the Chapter on " Residence."

The basis of liability under these cases for years to 1926-27 inclusive was " the full amount of the balance of the profits or gains upon a fair and just average of the three years ending on that day of the year immediately preceding the year of assessment on which the accounts of the said trade have been usually made up or on the 5th day of April preceding the year of assessment."

The application of the averaging principle to new businesses, during the years of assessment with regard to which a complete period of three trading years ended prior to the year of assessment did not exist, was subject to certain modifications. Similarly, special provisions existed for the adjustment of assessed liability for the

year of cessation of a trade, &c., and for the revision of the period of the three years of assessment prior to the year of cessation.

From 1927-28, however, the legal basis of liability on the income from subjects under Cases I and II of Schedule D is the full amount of the profits or gains or income of the year preceding the year of assessment.

(Concerns assessed to 1926-27, inclusive, under No. III of Schedule A (e.g. railways, mines, quarries, &c.) on bases specifically applicable to those subjects, are, from 1927-28 inclusive, transferred to Case I, Schedule D, and are governed by the rules and provisions applying to assessments under that case.)

A chapter headed " Basis of Assessment " has been devoted to the explanation of the basis of liability as it is applied to new businesses, existing businesses, ceasing businesses, and businesses changing hands by sale or transfer.

For Income Tax purposes, the term " profits or gains " requires a special interpretation, and the chapter on " Profits " will explain the considerations to be taken account of in this connection.

CHAPTER XI

PROFITS

Although the charging section of Schedule D directs that Income Tax is to be charged on the "*annual profits or gains*" arising from a trade, &c., and the rule of Case I, Schedule D, specifies that the charge is to be computed on the full amount of *the profits or gains* or income of the year preceding the year of assessment, it is significant to note that nowhere is the expression "profits or gains" specifically defined.

It has been left to litigation to decide what interpretation is to be put upon the expression, and there has evolved from the many cases which have at various times been the subject of Court decisions, a practical and comprehensive interpretation of the term.

In the rules applicable to Cases I and II of Schedule D, there have been enumerated certain deductions and allowances (e.g. depreciation, obsolescence, &c.), which are to be made either in arriving at the amount of the profits or from the ascertained assessable profits, but more particularly there have been enumerated certain deductions or expenses which are inadmissible charges against the profits. The information supplied by the Act itself

in connection with the expenses which are legitimate charges against trading profits is chiefly negative. The whole question of the admissibility or non-admissibility of expenses in calculating the profits of a trade for Income Tax purposes turns on the expression "wholly and exclusively laid out or expended for the purposes of the trade."

Any expenses—however commercially expedient or necessary they may be from the point of view of the proprietor—which do not *necessarily* arise in the course and for the purpose of earning the profits may be deemed to be inadmissible for Income Tax purposes.

For Income Tax purposes it is necessary to consider the expression "balance of profits or gains" as indicating the profits or gains of the trade or business after elimination of expenditure which may have been charged in the Trader's Accounts, but which is not admissible for Income Tax purposes, and, conversely, after allowance of expenditure which the trader may have omitted to charge against Revenue, but which is a legitimate charge for Income Tax purposes against the business profits.

In this connection it is customary to speak of the "adjusted profits for Income Tax," meaning the profits of the business shown in the Financial Accounts adjusted by the exclusion and inclusion of inadmissible and admissible expenditure respectively.

It is desirable at the outset to familiarise oneself with the expression "balance of profits or gains," giving to the expression the significance which attaches to it for Income Tax purposes. This is, perhaps, best achieved by a consideration of one or two excerpts from cases settled in Court, where pronouncements have been made as to the manner in which the phrase is to be construed.

(*a*) " Profits and gains must be estimated on ordinary principles of commercial trading by setting against the income earned the cost of earning it, subject to the limitations prescribed."

(*b*) " That which has to be assessed is the balance of the profits or gains of a trade ; that is to say, the sum left after subtracting the *proper* deductions from the profits or gains. . . . The Act does not affirmatively state what losses may be deducted. It prescribes merely negative information."

(*c*) " The expression ' balance of profits and gains ' implies, as has often been pointed out, something in the nature of a credit and debit account, in which the receipts appear on one side, and the costs and expenditure necessary for earning these receipts appear on the other side. Indeed, without such account it would be impossible to ascertain whether there were really any profits on which the tax could be assessed."

(*d*) " The Income Tax Acts expressly forbid certain deductions which might be thought allowable before the true profits of a trade could be ascertained, but, with this exception, ' profits of a trade ' bears its ordinary signification as used by business men in business."

It will readily be inferred from the foregoing dicta that the profits of a trade, so far as the term has a particular significance for Income Tax purposes, does not necessarily coincide with the figure of profit reflected in the ordinary Financial Accounts. At the same time, in order to be in a position to make a correct return of profits, the taxpayer must keep accurate accounts of his trading. These accounts must be prepared in accordance with ordinary commercial practice, that is to say, a balance must be struck at two successive dates. Where stock is carried, a valuation must be made at each date, and the profit or loss in the period between the two dates must be ascertained.

In those cases where the taxpayer, though required to render a return of the profits of his trade for assessment purposes, does not keep such records of his trading transactions as would enable him to prepare Financial Accounts, estimated assessments may be made by the Commissioners if they are not satisfied that the figure of profit returned for assessment purposes is adequate. Consequently, though there is no legal obligation on the taxpayer to keep Books of Account and prepare Financial Accounts of his business, where appeal is made against an estimated assessment as being excessive, no application for a reduction of the assessment will be sustained unless such evidence as is afforded by Financial Accounts or other records is available.

It will be seen, therefore, that the ascertaining of the balance of profits or gains of a trade, &c., with reference to which the Income Tax liability under Cases I and II of Schedule D is to be assessed, presupposes the preparation of some kind of Financial Accounts made up at intervals. Where stock is carried in the trade, a valuation of stock should be made at the respective dates when a balance is intended to be struck. Such accounts will reflect the financial results of the trading operations of the period covered by the accounts. The form and preparation of the actual accounts need not be discussed here, as these belong to the province of accountancy; these may range from the simple cash account to the ordinary Trading, Profit and Loss Accounts and Balance Sheets, embodying a complete system of double-entry book-keeping.

The Inland Revenue authorities are not primarily concerned with the accounts themselves, but only with the figure of profit or loss which they reflect. As a matter of practical convenience, however, it is usual to supply the Inspector of Taxes with a copy of the accounts of the concern for each financial year.

From the balance of profit or loss appearing in the accounts, adjusted as necessary for Income Tax purposes, the profits for assessment purposes are computed.

There are now to be considered at greater length the adjustments which fall to be made in the profits figure of the Financial Accounts in order to arrive at the assessable profits.

It is usual for the Inspector of Taxes, in the course of his examination of the accounts submitted to him, to raise such questions as he deems to be necessary in order to provide him with the information which he considers indispensable for an adjustment of the accounts' balance for Income Tax purposes. It is, of course, a matter of great practical convenience, in those cases where a qualified accountant is acting on the taxpayer's behalf, if, when submitting the taxpayer's accounts, the accountant can furnish the Inspector with either a computation containing the necessary Income Tax adjustments, or such information on the accounts relative to admissible and inadmissible charges as will enable the Inspector to complete his computation. Such knowledge on the part of the accountant is obtained from an intimate acquaintance with the Income Tax Act itself, and from experience of the Inland Revenue Authorities' attitude to, or interpretation of, certain matters of principle. On many occasions the accountant (or the taxpayer himself) and the Inspector may find themselves on debatable ground, where no hard and fast rules seem to apply, and where the case is one for a consideration of the special circumstances pertaining thereto ; in many such cases the policy of " give and take " is the most expedient and a compromise may readily be effected ; in others, however, where the official Revenue attitude does not seem to be consistent with the provisions of the Act or where peculiar circumstances arise which do not appear to be covered by the

ordinary provisions of the Act, and the taxpayer appears to be receiving harsh treatment, a decision on the point may be obtained by resorting to the ordinary appeal machinery provided by the Act.

It is impossible for anyone to attempt to do what the framers of the Income Tax Act themselves studiously refrained from doing, namely, to give an exhaustive list of the deductions and expenditure which may legitimately be claimed as proper charges against business profits or to formulate any rules governing the disallowance of inadmissible charges. At the same time it is necessary to understand the scope of the provisions regarding business expenditure embodied in the rules applicable to Cases I and II of Schedule D.

In a consideration of all expenditure incurred in connection with the pursuit of a trade, &c., *it is essential to bear in mind the difference between capital and revenue expenditure.* Before expenditure can be claimed as a charge on the business profits, it is not enough that it should have been incurred *in connection with* the business. There are many types of expenditure which the prudent trader incurs in the course of his business, which, while they have been incurred with a view to profit-making, cannot be said to have been "wholly and exclusively laid out or expended for the purpose of the trade" or in *the course of* earning the profits which are sought to be assessed. Thus, while it may be admitted that the purchase price of a business, the preliminary expenses of a company, the cost of fitting up the premises in which the trade is to be carried on, the purchase of a cash register, the installation of some improved type of machinery, the voluntary removal of the business to a more favourable site—to mention only a few of many possible contingencies—are all moneys expended for the purpose of the trade and with a view to profit-making,

they are not moneys necessarily expended in the course of earning the profits, but rather *prior* to the earning of the profits, or with a view to *creating* the conditions necessary to enable profits to be made, and as such, must be regarded as capital expenditure. Again, provisions or reserves for depreciation or bad debts, contributions to sinking funds, &c. &c., while they remain commercially expedient or necessary charges upon the business profits, are to be regarded for Income Tax purposes as transfers of profit and consequently are not admissible deductions in arriving at the "balance of profits or gains." Ordinarily, revenue expenditure must receive a very strict interpretation as being expenditure without which the profits could not have been earned.

Any expenditure charged against the business and incurred by the proprietor as an individual must, of course, be eliminated in arriving at the assessable profits of the business. Such expenditure would include all personal disbursements of the proprietor, the value of goods taken from stock for personal or household use (where these are not paid for in cash or credited to sales) and the values of contra accounts with other tradesmen where similar credits have not been made. Any sums taken by the proprietor or partners as wages and charged against profits under that or any other head must, of course, be disallowed, these being merely part of the business profits withdrawn periodically instead of at the end of the year or balancing date.

Where the proprietor resides in the premises where the business is carried on, only such proportion of the total rent of the premises as represents the rental value of the part used for trading purposes constitutes a legitimate charge against the business profits. A disallowance must, therefore, be made of part of the total rent—where the latter has been charged against business profits

corresponding to the rental value of the part of the premises occupied residentially. Rates should be treated in the same manner.

Similarly, where the total cost of heating, lighting, &c., for the whole of the premises has been charged as revenue expenditure, a proportionate part must be disallowed to cover the value of these subjects consumed for private purposes. This situation is not infrequent in the case of small traders, and is more prevalent among professional men like doctors, dentists, &c.

It is usual in such cases to divide the total rental of the premises in the proportion which the number of rooms used for private residential purposes bears to the total number of rooms in the premises ; similarly, with the charge for common conveniences used in the premises or burdens falling thereon, e.g. coal, light, municipal and other local rates. Thus, where in a house of, say, nine rooms, six of these were used exclusively for business purposes, and the total rent of the premises, and the total cost of coal, light, &c., had been included in business expenditure, one-third of the rent and one-third of the cost of coal, &c. &c., would normally be disallowed as representing expenditure laid out by the proprietor as an individual as distinct from the proprietor in pursuit of his trade or profession. It is not to be assumed, however, that any hard and fast method of disallowing expenditure of the kind indicated above is in vogue, for as a matter of fact the basis on which expenditure of this kind is apportioned is often a matter of arrangement with the Inspector on a consideration of the particular circumstances of the case.

In passing, it may be mentioned that a compromise has often to be effected in the very common case of charges for maid's wages, where the maid's services are divided

between ordinary household duties and duties directly arising in connection with the trade or profession.

In those cases where the business premises or land, &c., are *owned* by the proprietor, and occupied for the purposes of the business, and where, therefore, no rent is paid for the occupation, the proprietor is allowed to charge against the profit an amount *in lieu of rent* equivalent to the Net Annual Value of the premises, &c., so owned and occupied.

In some cases it is customary for the owner-occupier of business premises to charge against business profits a nominal rent—this may be a contra entry only—which may be less than, or in excess of, the Net Annual Value of the premises as assessed under Schedule A. In either case the book entry for rent in the accounts is eliminated, and the Net Annual Value allowed as a deduction.

In cases where the owner of the business resides on the premises an allowance is granted not exceeding two-thirds of the annual value or rent paid, unless in a particular case the Commissioners consider that a greater amount ought to be deducted (an allowance greater than two-thirds is most frequently given in the case of hotels).

It should be noted that the allowance in respect of property, land, &c., owned and occupied for the purpose of a trade does not extend to property *situated abroad*, except in so far as the Finance Act, 1919, allows a deduction of one-sixth of the *Annual Value* of property owned abroad and occupied for trade purposes where the property consists of *mills, factories* or *similar premises*. (The ascertaining of the *Annual Value* in the case of such property abroad often presents a difficult problem but is usually determined by reference to the cost price and the Net Annual Value of similar property in the United Kingdom.)

The 1918 Act permits the allowance in respect of property consisting of mills, factories or similar premises owned and occupied for trade purposes in the United Kingdom (normally the net annual value) to include the net annual value plus the allowance for repairs. In England this is equivalent to the gross Schedule A assessment.

In Scotland, however, where the burden of owners' rates falls on the proprietor of property and where the gross Schedule A values are inclusive of owners' rates for which a deduction is granted from the assessment, the practice has been to allow as a deduction for business premises in the nature of mills, factories, &c., an amount equivalent to the net Schedule A plus repairs. A recent case, however (*The Scottish Central Electrical Power Co. v. Commissioners of Inland Revenue*) has decided that the allowance to be granted is the gross Schedule A of such premises. Owners' rates on the business premises were allowed as a trading charge in the accounts ; the Inland Revenue, in order to counter the double allowance which would thus be made for owners' rates, viz. as a charge in the business accounts and again by inclusion in the amount allowable for Schedule A allowance (viz. the gross Schedule A assessment), has taken to disallowing the owners' rates on business premises as a charge against business profits on the ground that such rates are a charge on the owner *qua* owner and not *qua* trader. It remains to be seen whether this attitude on the part of the Inland Revenue authorities will be upheld by the Courts in the event of an appeal being taken on the point.

The position, of course, is peculiar to Scotland and the relative section of the Income Tax Act, 1918, increasing the allowance for certain business premises beyond the net annual value, did not have regard to the peculiarity of property assessments in Scotland as regards owners' rates.

It should be noted that this increased allowance is granted only in respect of those buildings which are in the nature of mills, factories or similar premises. These are usually identified as buildings where permanent machinery is attached to the structure (for productive processes). The allowance simply recognises that the vibratory disturbance set up by heavy machinery in motion is bound to weaken surrounding structural work.

It should be noted that the amount to be deducted as the Net Annual Value of business premises, &c., owned and occupied is the Net Annual Value covering the period of the accounts, because it is an allowance in lieu of rent. For example, if accounts of the trader's year close on 30th September 1927, the amount to be allowed from the profits of that period in respect of business premises owned and occupied would be one-half of the net Schedule A assessment for 1926-27 (covering the period from 1st October 1926 to 31st March 1927) and one-half of the net Schedule A assessment for 1925-26 (covering the other half of the trader's financial year).

The amount of expenditure in any year or accounting period on the repairs and upkeep of the business premises, or on the repairs or alteration of implements, utensils or articles employed in the trade, forms a legitimate charge on the business profits of the period in which the moneys were so expended. At first sight it might seem that the allowable expenditure within this provision covered a great variety of subjects and was fairly comprehensive in its scope. As a matter of fact, however, the expenditure which may be claimed under the above headings is subject to many important limitations.

In the first place, only such outlay as may properly be

described as "*repairs*" comes within the scope of the allowance. For this purpose "repairs" is limited to the actual work necessary to maintain the premises, machinery or other subjects in their *ordinary* state, and in a fit condition to enable the profits to be made. Consequently a distinction must be made for Income Tax purposes between expenditure on work which has the effect of altering, improving or extending the premises or other subjects, and outlay which results only in maintaining these in their normal satisfactory condition. It may often happen that both the elements of ordinary repair and improvement or extension are common to expenditure, and in this case the Revenue authorities are quite entitled to analyse the expenditure with a view to discovering what amount refers to ordinary repairs and is chargeable against the business profits, and what refers to improvements, &c., and falls to be regarded as capital expenditure. The distinction between repairs and improvements is often a very subtle one and not easily appreciated by the business proprietor whose point of view may, to some extent, be determined by the commercial necessity or expediency of the outlay. It is a common belief among taxpayers (particularly of the business community) that any expenditure incurred in the course of trading, which has for its immediate or ultimate object the increasing of business profits, ought to be regarded as an admissible charge against the business profits as and when the money is expended. From the trader's point of view such an opinion seems wholly justified, but it has to be remembered that the Revenue Acts are only concerned with assessing profits as and when they arise, and do not concern themselves with what has to be done by the trader before the profits can be made. The only expenditure which is considered to be legitimately chargeable against business receipts is the *annual, recurring* expenditure which the trading transactions involve.

Losses which do not arise directly in the business, and as a result of the trading operations, are not regarded as proper business expenditure. It may happen, for instance, that part of the business assets consist of investments, e.g. Shares in a Limited Company. If the shares are realised for less than their cost price, any deficiency arising therefrom will not be an allowable charge against the business profits. This loss must be regarded as a loss of capital not arising in the ordinary course of trading. Similarly, of course, where a profit arises on the realisation of shares or any business asset, the difference between sale and cost price does not form part of the business profits.

No allowance is made for any capital withdrawn from the business, or for any sums employed, or intended to be employed, as capital in the business. It makes no difference from a Revenue point of view whether the capital in a business is possessed by the proprietor or consists of loans to him. The profits arise from the actual trading which is independent of the nature of the money capital.

Where a charge is made for interest on capital employed in a business the amount of the interest so charged is not an admissible deduction in arriving at the profits.

Where, in the course of trading, &c., bad debts are incurred, the amount of the debts so incurred in the accounting period may be charged as business expenditure. For this purpose, however, the debts must actually have been considered bad and written off in the books as irrecoverable. The treatment of bad debts in connection with a trading concern is one that should receive careful consideration; the practice in connection with the writing off of debts is one that is not subject to uniformity of treatment. Some business proprietors are conserva-

tive in the matter of writing off debts ; others are prone to write them off before they have been ascertained to be wholly irrecoverable. As a general rule, however, where the circumstances of the debtors are such as to justify the assumption that the debts will not be recovered, the latter should be written off and the amount claimed as ordinary business expenditure. If any sums are recovered in respect of bad debts written off, subsequent to the date of the writing off, the amounts so recovered must be brought to the credit of business receipts at the date when the recoveries are made.

Where, however, debts, though not considered to be wholly irrecoverable, are still thought to be doubtful, an allowance may be claimed to the extent to which the debts are considered to be doubtful. For Revenue purposes a specific valuation requires to be put on the debts before any allowance in this respect will be admitted.

The Inland Revenue practice is strictly against the allowance of " Reserves " whether for bad debts or any other contingency. The reason for this is obvious ; the amount of the reserve to be created is often a matter of personal opinion, and the allowance of such a reserve would entail on the part of the Inland Revenue Authorities a very laborious scrutiny of the amount of the Reserve and of any subsequent movements in the Reserve Account. It is much more satisfactory to deal with debts by considering those altogether irrecoverable, or, in the case of a trade where the amount of debtors is abnormally large, and where there is an element of uncertainty as to their being collectible in full (e.g. in the case of credit drapers) by coming to some definite arrangement with the Inland Revenue Authorities as to the extent to which allowance may be made for doubtful debts. It is common practice in cases of this kind for a specific allowance (usually 5 per cent.) to be made on the value of debtors

at each balancing date, any difference in the value of the so-called "Doubtful Debts Reserve" at successive balancing dates being passed through Revenue Accounts as a debit or credit entry.

Where sums are recoverable under an insurance or contract of indemnity, no allowance against profits can be claimed in respect of the amounts or losses so recovered.

In connection with Insurance generally it may be noted that annual premiums for burglary, fire and similar insurance are allowable business expenditure. Where, on the happening of the contingency specified in the contract of insurance, sums are recovered by the business, such amounts of the total recoveries as represent indemnification for the loss of ordinary trading stock must be regarded as ordinary business receipts; such part of the recoveries, however, as refer to purely capital assets, e.g. Building, Plant and Machinery, &c., the values of which do not affect the Trading or Profit and Loss Accounts, are not to be included as Revenue receipts.

The treatment of "Loss of Profits" insurance premiums may be specially commented on. Strictly speaking, the payment of such premiums is not regarded as money wholly, exclusively, or necessarily laid out for the purpose of the trade, but rather as money expended with a view to covering the period during which it would be impossible to earn profits. As a matter of practice, however, the amount of the annual premiums for insurance of this kind will be allowed as a charge against profits, where an undertaking is given by the concern paying the premium that receipts from this source will be accounted for as part of the ordinary business revenue.

Where any *annual* interest, annuity, or other *annual*

payment is made out of the business profits or gains, no allowance is admissible in respect of such payments. The nature of annual payments and their treatment for Income Tax will be more fully discussed in the Chapter on " Annual Charges." In passing, however, it may be noted that where anyone is liable to make an *annual* payment, the payer should deduct Income Tax at the full standard rate of tax in force during the period from the amount of the payment ; the recipient in turn is under a legal obligation to accept the net amount in full discharge of the payment, and should receive from the payer a certificate to the effect that Income Tax at the full standard rate has been deducted from the gross amount of the payment due, and will be duly accounted for to the officer for the collection of taxes.

It follows, therefore, that as the payer of such annual charges has acted in the capacity of collector of Income Tax on the amount thereof, no allowance can be made to him of the amount of the payment ; on the other hand, the tax which he has retained will be recovered from him by inclusion of the amount of the payment in the profits or other income upon which he is assessable to Income Tax.

It should be noted that interest paid to a bank on an overdraft does not come within the term " annual interest." *Annual* or *yearly* interest, for practical purposes, may be taken to mean interest payable at a fixed or ascertained rate on a fixed amount, or as was stated in the course of a tax case on the subject—

> " Yearly interest means, substantially, interest irrespective of the precise time in which it is collected, interest on sums which are outstanding by way of investment as opposed to short loans or to moneys presently payable and held over. . . ."

Overdraft interest, which is calculated with reference to

fluctuating balances and at varying rates (bank rates), does not, therefore, constitute annual interest, and is, consequently, payable in full, and allowable as an ordinary business expense.

The computation of the profits of a trade, &c., is to be made exclusive of the profits or gains arising from property, lands, &c., occupied for the purpose of the trade. Such property, of course, is assessable under Schedules A and/or B, and if the proceeds of these subjects were again included with the business profits, a double assessment would arise.

It often happens, however, that a trading concern holds property which it may let to tenants. Ordinarily, the rents from such property will be credited to Revenue direct, and outgoings such as property tax, rates, insurance, feu duty, mortgage interest, &c., charged as Revenue expenditure ; or the rents will be credited to a Property Revenue Account to which will be debited the outgoings referred to above, and the balance of the account transferred to Profit and Loss Account. In strictness, all entries, debit and credit, relating to such property should be eliminated from the accounts in ascertaining the adjusted profits of the business, but in actual practice the Inland Revenue treatment of property in this respect varies.*

In some cases, all the entries relating to the property are eliminated except the admissible charges *on the property actually occupied for business* purposes, e.g. rates, owners or occupiers, repairs, insurance (feu duty, bond or mortgage interest, ground rents, casualties, &c., are not allowable charges as Income Tax is deductible from these at the time of payment). In other cases, where rents are

*Note.—In the case of properties occupied by employees, rents, if any, are allowed to remain at credit and a deduction made for the net Schedule A.

credited in respect of property owned and let, whether direct to Revenue or through a Property Revenue Account, the balance of which is transferred to Revenue, the entries are retained and the deduction for net Schedule A is made to include the property so owned and let. In these cases, of course, there fall to be disallowed all inadmissible charges (e.g. feu duty, &c., indicated above), whether charged direct to Revenue or through the property Revenue Account.

It is best, however, to adhere to the strict legal treatment of such subjects and eliminate from the accounts all entries relating to property other than that occupied for business purposes.

Before leaving the subject of admissible and inadmissible business expenses, it may be of advantage to make one or two comments on items which normally form part of the business expenditure of the ordinary trading concern and in respect of which there has been established a definite Income Tax practice.

Removal Expenses.—Where the removal is voluntary, the whole of the cost is normally regarded as capital expenditure, though in actual practice the cost of transferring stock-in-trade is allowed. Where the removal is compulsory, the actual cost (exclusive of any capital outlay which can readily be identified as such) will generally be allowed.

Subscriptions.—(*a*) *Charitable Subscriptions*.—There are no express provisions in the Income Tax Act with regard to these, and consequently the expenditure must be interpreted with reference to the phrase " wholly, exclusively and necessarily laid out for the purpose of the trade."

In actual practice it is customary to admit as expenses subscriptions allocated to charitable institutions from which the trade or those engaged therein (including

employees) would be likely to derive some benefit, e.g. subscriptions to infirmaries, hospitals, seaside homes, asylums, &c., where these are maintained substantially by public subscription.

(*b*) *Trade Subscriptions.*—Many associations in connection with, or for the furtherance of, particular trades are now in existence. Some of these are in themselves trading bodies (and consequently liable to assessment on their profits), but the majority of them are non-trading and exist principally to further and protect the interests of particular trades. An arrangement has been made by the Board of Inland Revenue whereby, upon an undertaking in writing by the Trade Association to pay Income Tax upon the excess of its receipts over expenses, the amount of the subscriptions or levies contributed by the members of the association will be allowed as business expenses in computing the assessable profits of the latter. Negotiations are entered into between the Association and the Inland Revenue Authorities direct, and the Inspectors of Taxes are furnished with the names of all societies or associations which have been admitted to the arrangement, so that they may be in a position to determine whether or not such trade subscriptions are properly allowable expenses.

Legal Expenses.—If these expenses are incurred in connection with the ordinary business, or arise out of circumstances pertaining thereto, they form a proper charge against profits; otherwise they fall to be regarded as capital expenditure—

e.g.: Allowable—in connection with collection of debts, defence of existing trading rights, &c.

Not allowable—in connection with lease of premises, partnership or dissolution arrangements, transfers of property, contract for sale of business, registration of company, reduction or increase of capital, &c.

Patent Fees and Royalties.—Normally these are inadmissible charges against business revenue, being in the nature of "annual payments." Book royalties, however, are usually paid in full and assessable on the recipient, and consequently allowable as a business charge in the accounts of the payer.

The cost of acquiring new patents is not an admissible charge, but the expense of renewing expired patents is admitted.

Depreciation.—Where a charge is made in Revenue expenditure for depreciation of capital assets like buildings, plant, machinery, fittings, leases, &c., such amounts fall to be disallowed. Even where the assets are of a wasting nature and are actually consumed in the production of the profits (e.g. a coal mine) no allowance can be claimed in respect of the reduced value of the assets.

It is, however, specifically provided in the Income Tax Act, 1918, that a deduction may be *claimed yearly* from the ascertained profits to be charged (i.e. the actual amount of the assessment) in respect of the diminution in value *by reason of wear and tear* during the year of any *machinery or plant* used for the purpose of the trade and belonging to the person by whom the trade is carried on.

Renewal of Plant, Machinery, &c.—Where an annual claim is *not* made to have a deduction in respect of wear and tear from the ascertained amount of the assessment, it is customary to allow the cost of renewals and replacements of plant, &c., actually worn out in the earning of the profits, as a *business expense* of the accounting period in which such replacements take place.

The subject of depreciation and renewals, however, is dealt with in a separate chapter.

Income Tax.—Income Tax in any shape or form is always regarded as a non-allowable charge against income. The

tax itself falls to be regarded, not as an expense incurred in earning the income, but as the State's appropriation of part of the income in return for the security, &c., afforded by the public services which enable all enterprises to be carried on.

The only exception to the above rule occurs where the Income Tax on employees' liability (including that on directors' fees) is paid by the employer (including a company). In such cases, as the amount of the Income Tax paid on the employees' behalf is regarded as additional salary or remuneration, and taken into account in arriving at the amount of the Schedule E assessments on the employees, it is allowed as a deduction in adjusting the profits.

Expenses of Issue of Debentures.—These are, in the first instance, regarded as capital expenditure, but where the debentures, on maturity, are renewed, the costs of renewal will be admitted as a Revenue charge in the case of financial companies or other companies dealing in money.

The fees paid to Trustees for debenture holders are allowed for Income Tax purposes, such fees being assessable on the recipients under Schedule E.

Where part of the income of a business consists of either interest received without deduction of tax, e.g. War Loan interest or Deposit interest (which is separately assessable under Case III of Schedule D) or income received under deduction for tax, e.g. dividends, &c., and where such income has been credited to Revenue, the relative credits for these items are eliminated in arriving at the adjusted profits.

The following examples illustrate the manner in which accounts are adjusted for Income Tax :—

EXAMPLE I

The following is the Profit and Loss Account of A.B.C. & Co. for the year to 31st October 1927.

Dr.		*Cr.*	
	£		£
To Stock	1,200	By Sales	17,511
,, Purchases ..	8,500	,, Stock	1,600
,, Wages	5,400	,, Net Revenue from Property	80
,, Carriage	550		
,, Gas, Water and Municipal Rates	260		
,, Salaries (Partners)	800		
,, Bad Debts ..	140		
,, Repairs to Buildings	300		
,, Repairs to Plant	200		
,, Income Tax ..	101		
,, Interest on Capital	250		
,, Interest on Overdraft from Bankers ..	80		
,, Rent of works charged at 6 per cent. on cost ..	300		
,, Profit	1,110		
	£19,191		£19,191

In practice it is desirable, in arriving at the adjusted profits for Income Tax purposes, to commence with the balance of Profit or Loss as shown in the accounts and work upwards through the debits, disallowing all items of an inadmissible nature. Thereafter the credit side should be examined with a view to excluding items which do not form part of the ordinary business profits.

Applying this method (which conforms with Inland Revenue practice) the adjustments in the above account would be carried out as follows :—

Balance—Profit—Per Accounts		£1,110
Add : Rent of Works		300
(The works are owned and occupied and this is only a nominal rent which, it may be assumed, is credited to Capital Account(s). The net Schedule A in lieu of rent will be allowed (see below)).		
Interest on Capital		250
Income Tax		101
Partners' Salaries		800
		£2,561
Less—		
Net Revenue from Property	£80	
(This is the net Revenue from Property owned and let and is excluded. No Schedule A is allowed in this respect.)		
Net Schedule A	200	
Add—		
Repairs Allowance Schedule A (on factory) .. .. (say)	50	
		330
Adjusted profits for year		£2,231

After the calculation of assessable profits, the appropriate depreciation allowance is deducted. The method of dealing with depreciation is described in a subsequent chapter.

EXAMPLE II

The following Profit and Loss Account, and Profit and Loss Appropriation Account are taken from the Financial Accounts of the A.B.C. Co., Ltd., for the year to 31st December 1927 :—

Dr.	£	s	d	*Cr.*	£	s	d
To Stock at 1st Jan. 1927	642	7	8	By Sales	22,460	6	4
,, Purchases ..	17,130	2	5	,, Property Revenue Account ..	263	1	7
,, Discount ..	240	11	8	,, Discount ..	215	8	4
,, Rates and Taxes	480	3	9	,, Stock at 31st Dec. 1927	710	9	6
,, Advertising ..	25	6	4				
,, Stationery ..	34	8	9				
,, Telephones ..	62	4	8				
,, Insurance ..	132	4	5				
,, Salaries ..	800	0	0				
,, Wages	680	0	0				
,, Travelling Expenses	160	9	8				
,, Freight and Carriage ..	340	10	2				
,, Cartage	350	8	9				
,, Postages ..	32	4	8				
,, Sundries ..	85	9	6				
,, Interest	120	6	8				
,, Preliminary Exps.	150	4	2				
,, Income Tax ..	290	2	5				
,, Bad Debts ..	63	8	10				
,, Charges	509	8	4				
,, Repairs	186	13	4				
,, Depreciation ..	250	0	0				
,, Balance to Appropriation A/c	882	9	7				
	£23,649	5	9		£23,649	5	9

P. & L. Appropriation Account

Dr.	£ s d	*Cr.*	£ s d
Dividend paid 30th June 1927	5,000 0 0	Balance b/f	13,284 15 6
Directors' Fees ..	500 0 0	Balance from P. & L. A/c	882 9 7
Balance to B/S ..	8,667 5 1		
	£14,167 5 1		£14,167 5 1

On inquiry the following points emerge :—

(*a*) *Charges* £509 8s. 4d. This amount includes Mortgage Interest (net) amounting to £98 15s. 6d., and Property Tax (i.e. Schedule A Income Tax) £45 10s. 6d. It also includes subscriptions as follows :—

(1) Associations under arrangement £8 8s.

(2) Associations not under arrangement £7 7s.

(*b*) *Interest* £120 6s. 8d. This amount is made up as follows :

To	£ s d	By	£ s d
Bank Overdraft Interest ..	168 0 0	War Loan Interest ..	50 0 0
,, Loan Interest (tax deducted)	70 6 8	,, Taxed Dividends	68 0 0
		,, Balance to P. & L. A/c ..	120 6 8
	£238 6 8		£238 6 8

(*c*) *Rates and Taxes* £480 3s. 9d. This amount includes the sum of £38 9s. 8d. in respect of property owned but not occupied by the Company..

In calculating Income Tax liability it is the ordinary practice to compute to the nearest £, i.e. sums less than

10s. are ignored and those over 10s. are treated as £1. Thus, in adding back, in computations, £45 10s. 6d. would be taken as £46.

The adjustments are as follows :—

Balance—Profit—Per P. & L. Account		£882
Add : Depreciation		250
Inadmissible " Charges " (as above)—		
Interest	£99	
Property Tax	46	
Subscriptions	7	
	—	152
Income Tax		290
Preliminary Expenses		150
Interest (Loan Interest)		70
(And see below.) This being annual interest and payable under deduction for tax is an inadmissible charge.		
Rates and Taxes (see above)		38
		£1,832
Less : Interest—War Loan—assessable separately under Case III	£50	
Interest—Taxed	68	
Directors' Fees	500	
(It should be noted that Directors' Fees have been charged to Appropriation Account and will, therefore, require to be treated as a deduction in dealing with the Profit and Loss Account Balance.)		
Property Revenue Account	263	
Net Schedule A (say)	200	
(This refers only to property owned and occupied by the Company.)	—	1,081
Adjusted profit		£751

N.B.—In addition to the profits assessment under Case I there will be liability under Case III in respect of the above untaxed interest of £50.

EXAMPLE III

The following is the Profit and Loss Account of the X.Y.Z. Co., Ltd. :—

Dr.	£	*Cr.*	£
To Bad Debt Reserve	350	By Trading Profit ..	1,788
,, Directors' Fees ..	1,000	,, Dividends (net) ..	150
,, Income Tax—Sch. D.	250	,, Net Loss for year	300
,, Sch. E	100		
,, Reserve for Cash Discount* ..	250		
,, Debenture Interest (net)	190		
,, Legal Expenses ..	98		
	£2,238		£2,238

The following points should be noted before making the adjustments :—

(*a*) *Legal Expenses* £98. This includes the sum of £46 in connection with the obtaining of loans and this amount, referring, as it does, to capital, is inadmissible.

(*b*) *Reserve for Cash Discount* £250. This is calculated at the normal rate of the trade on the amount of the debtors at the date of balance. In these circumstances, as the amount fairly accurately represents a real contingency, it is allowable. This is one of the few exceptions where " Reserves " are allowed in adjusting profits.

*Note.—This is after adjustment for Reserve at the beginning of the year.

The adjustments are as follows :—

Balance—Loss—Per P. & L. Account		£300
Less : Legal Expenses (see above)	£46	
Debenture Interest	190	
Income Tax, Schedule D	250	
Bad Debt Reserve	350	
		836
Profit		£536
Deduct : Dividends (net)		150
Adjusted profit		£386

It will be noted that after all appropriate adjustments have been made, the loss, per accounts, is converted into a profit for Income Tax purposes.

CHAPTER XII

BASIS OF ASSESSMENT

The discontinuance of the average basis of assessment as from 1927-28, inclusive, and the substitution therefor of the income of the preceding year brings about a simplification in the calculation of assessable profits for Income Tax purposes, particularly with regard to businesses where, on account of the business having been commenced within the period of three years prior to the year of assessment on which the average was calculated, the liability for the early years of the business required to be calculated on a modified application of the averaging principle.

At the same time, more specific directions with regard to the calculation of the assessable profits of a business, &c., in its first or second year and in the year of cessation are given effect to by the Finance Act, 1926.

As before, the trader, &c., can make up his accounts for any accounting period he chooses to adopt.

For the purpose of ascertaining the profits or gains of the year preceding the year of assessment, however, the following rules are applied :—

(*a*) Where only one account was made up to a date within the year preceding the year of assessment, and that account was for a period of one year, the profits or

gains of the year ending on that date are taken to be the profits or gains of the year preceding the year of assessment.

(*b*) If no account for a period of one year was made up to a date within the year preceding the year of assessment or if more accounts than one were made up to dates within that year, the Commissioners of Inland Revenue have the power to determine what period of twelve months is to be deemed to be the year the profits of which are to be taken as the profits of the year preceding the year of assessment.

Further, if the Commissioners of Inland Revenue, in consequence of their decision regarding the period of twelve months to be taken as the preceding year for purposes of ascertaining the profits or gains for assessment purposes of any year of assessment, are of opinion that the previous year's assessment requires amendment, either by increase or reduction, to bring it into line with their decision (i.e. so that the liability for that year may be based on the profits of a period corresponding with the period adopted by them), they may direct that an additional assessment be raised for the previous year or that a repayment be made out of the original assessed liability.

An appeal against any such additional assessment or in respect of any repayment of tax made or directed to be made under this provision by the Commissioners of Inland Revenue may be made by the taxpayer concerned to the General or Special Commissioners whose decision is final, subject to the ordinary provisions for the statement of a case to a Higher Court of Appeal.

These provisions for revision of past assessments do not apply so as to affect any year prior to 1927-28 (that being the first year of the new basis).

Assessments or additional assessments requiring to be made under these provisions in the case of a business, &c., belonging to a deceased person may be made on the executors or administrators of such person.

The provision under paragraph (*b*) above was obviously necessary to meet those cases where the trader, &c., by changing the balancing date of his accounts, could so manipulate the amount of his profits within certain periods as to cause difficulty in ascertaining either what period of twelve months ended prior to the beginning of the year of assessment or what amount of profits for that period was to be accepted. The section provides machinery for meeting difficulties which may arise when the trader changes the date to which he makes up his annual accounts, or where his accounts are made up at irregular intervals.

Where it becomes necessary to divide or apportion profits to specific periods or to aggregate profits (e.g. to arrive at the liability for the first or last years of a business, or to calculate profits of a specific period of twelve months from the profits of one or more accounts covering a period or periods greater than twelve months) such division, apportionment, or aggregation is to be computed on a time basis, i.e. in proportion to the number of months or fractions of months in the respective periods involved in the calculation.

NEW BUSINESSES

The liability of a new business, trade, vocation, &c., for the year of assessment in which it is set up or commenced still remains to be calculated according to the rules of Case VI, the basis of which is still at the discretion of the Commissioners; this basis, however, from 1927-28, inclusive, must conform with either the actual income of the year of assessment or the income of the preceding year.

In effect, the liability of a business, &c., for the year of assessment in which it is first set up or commenced will be the actual profits or gains for the period of the year of assessment during which it existed, i.e. from the date of its commencement to the 5th April following, based on the results of the first accounts. The apportionment of the profits for this period is to be made on a time basis on the lines already indicated.

The liability of the second year of assessment (i.e. where the trade, &c., has been set up or commenced within the year preceding the year of assessment) requires to be calculated on the profits or gains for one year from the period of the first setting up of the trade, &c., i.e. on the profits or gains of the first twelve months from the date of commencement.

There is a provision, however, that, for this—the second—year of assessment of the business, &c., application may be made within twelve months after the end of the year of assessment to have the actual profits of the year substituted for the amount of the assessment; the apportionment of the profits of two or more accounts to give the actual profits will be applied.

DISCONTINUED BUSINESSES

Where a trade, profession, vocation, &c., is permanently discontinued in any year of assessment, the liability for that year is to be based on the actual profits or gains of the period of the year of assessment during which it continued in existence (i.e. from the 6th April to the date of cessation).

If more tax has been paid on an original assessment for the year of discontinuance than arises on the liability computed as above, repayment of the excess may be claimed; conversely, if the tax on the actual profits of

the period of the year of assessment is greater than the tax on the assessed profits, an additional assessment to cover the difference will be made.

Further, if the profits or gains of the year to 5th April preceding the year of assessment in which the trade is discontinued exceed the amount of the assessed profits for that year, an additional assessment will be made to raise the original assessment of that year to the amount of the actual profits. It is provided that any additional liability which may be found to be due under these provisions, in the case of a person who dies in the meantime, may be charged on his executors or administrators and the tax thereon is to be treated as a debt due from, and payable out of, the deceased's estate.

The following examples will illustrate the application of those rules of assessment.

EXAMPLES

I.—Trader's year ends 31st March.

Profits adjusted for Income Tax—year to 31st March 1927	£2,000
Liability, 1927-28	2,000

II.—Trader's year ends 29th September.

Profits adjusted for Income Tax—year to 29th September 1927	£608
Liability, 1928-29	608

NEW BUSINESS

III. Business commenced 15th October 1927.

Profits adjusted for Income Tax—year to 14th October 1928	£950

Liability—

(*a*) 1927-28—15th October 1927 to 5th April 1928 = 174 days,

$$= \frac{174}{366} \times 950 \quad \ldots \quad \ldots \quad \ldots \quad \ldots \quad £452$$

(*b*) 1928-29 (profits of trading year to 14th October 1927) 950

(*c*) 1929-30 (profits of preceding year) .. 950

Note.—If the profits of the year to 14th October 1929 were £600 a claim could be made to have the assessed liability for 1928-29 (£950) reduced to the actual profits of the year £784, viz. :—

6th April 1928 to 14th October 1928, 192 days

$$= \frac{192}{365} \times 950 \quad \ldots \quad \ldots \quad \ldots \quad \ldots \quad 500$$

15th October 1928 to 5th April 1929, 173 days

$$= \frac{173}{365} \times 600 \quad \ldots \quad \ldots \quad \ldots \quad \ldots \quad 284$$

£784

Such a claim requires to be lodged in writing with the Inspector within twelve months after the end of the year of assessment for which the claim is made.

(*d*) 1930-31 (profits of preceding year) .. £600

No claim for adjustment is competent for this year, as the business has not been set up or commenced within the year preceding the year of assessment.

DISCONTINUED BUSINESSES

IV.—Trader's year ends 31st December, business ceasing 30th September 1930.

Profits adjusted for Income Tax—

(*a*) Nine months to 30th September 1930 ..	£600
(*b*) Year to 31st December 1929	1,000
(*c*) Year to 31st December 1928	800
Liability as assessed, 1930-31 (profits of preceding year)	1,000

A claim may be made to have this assessment reduced to the actual profits of the period of the year during which the business was in operation, viz. :—

6th April 1930 to 30th September 1930 =

178 days = $\frac{178}{273} \times 600$	391
Liability as assessed 1929-30 (profits of preceding year)	800

As, however, the actual profits of the year 1929-30 were £950, as follows :—

6th April 1929 to 31st December 1929, say 9 months = $\frac{3}{4} \times 1{,}000$	£750
1st January 1930 to 5th April 1930, say 3 months = $\frac{1}{3} \times 600$	200
	£950

an additional assessment to bring the excess £150 (£950 − £800) into charge will be made.

V.—Trading year ends 31st December—business ceasing 30th June 1930.

Profits adjusted for Income Tax—

(*a*) Six months to 30th June 1930	£1,400
(*b*) Twelve months to 31st December 1929	600
(*c*) Twelve months to 31st December 1928	1,200
Liability, 1930-31 (profits of preceding year)	600
This will be revised by additional assessment to bring into charge a further £65 as the actual profit of the period 6th April 1930 to 30th June 1930 (date of cessation) amounts to £665	
viz., 6th April 1930 to 30th June 1930, 86 days	
$= \frac{86}{181} \times 1{,}400$	665
Liability, 1929-30 (profits of preceding year)	1,200
No revision of this liability is necessary, as the actual profit of 1929-30, £1,150,	
viz., 6th April 1929 to 31st December 1929, say 9 months, $= \frac{3}{4} \times 600$	£450
1st January 1930 to 5th April 1930, say 3 months $= \frac{1}{2} \times 1{,}400$	700
	£1,150

is less than the amount of the assessment.

The change over from the average of the three preceding years to the income of the preceding year as the basis of liability has statutory effect from the year 1927-28, inclusive.

A special relief provision, however, was designed (Section 29, subsection (3), Finance Act, 1926) to meet the cases of businesses, &c., which would be adversely affected by the change of basis during the transition stage.

Businesses, &c., which fulfilled the conditions required by Section 29 (3), Finance Act, 1926, could elect to continue to be assessed on the old average basis for 1927-28 and 1928-29. Where a claim was made for a continuation of the average basis (such a claim had to be intimated in writing to the Inspector not later than 5th October 1927), the computation of the liability for 1927-28 and 1928-29 will be made in accordance with the old basis of assessment relating to Cases I and II, Schedule D, as defined in the Income Tax Act, 1918.

From 1929-30 inclusive these concerns will come under the new basis of assessment, viz. the income of the previous year.

RELIEF IN RESPECT OF LOSSES

Where the accounts of a trader's year result in a loss, after the appropriate adjustments for Income Tax purposes, the liability falling to be based on the accounts of that year, i.e. the liability of the year of assessment following upon that trading year, is, of course, treated as nil.

Under the old averaging basis, the loss of any trading year normally affected the calculation of the average for three successive years, so that where profits were made in the other two years of the three entering into the average, automatic relief on the loss was obtained by inclusion to the extent of one-third in each of the averages. Obviously, in the change over from the average to the preceding year's basis, some system of allowing for relief on the loss of any trading year beyond the determination of the succeeding year's liability as nil was necessary, otherwise the taxpayer would not be compensated for the negative income represented by the loss.

Provision has, accordingly, been made whereby the loss incurred in any trading year may be set off, for Income

Tax purposes, against the profits or gains assessable under Schedule D in respect of the trade, &c., in which the loss arose for the six following years of assessment.

The loss so available for set-off will, of course, be the loss as reduced by any amount on which relief has been given by way of a claim under Section 34 (see chapter on "Claims") or set-off against the profits of another trade, &c. (Rule 13), or under any other relieving section of the Act.

The relief by way of set off is to be given from the first subsequent assessable profits and so on successively for each year until the loss has been exhausted or the six years' period has expired.

It should be noted that the profits available in any year of assessment for set-off against losses carried forward are the assessable profits as reduced by the wear and tear allowance for that year, e.g. :—

Example I. Loss available for carry forward from 1927-28	£1,000
Assessment 1928-29—profits of preceding year	£2,000
Less—Wear and Tear allowance for 1928-29 (including carry forward from 1927-28)	200
Profits available for set off against loss ..	1,800
Less—Loss carried forward	1,000
Net	£800
Example II. Loss available for carry forward from 1928-29	£500

Assessment 1929-30—profits of preceding year	£300
Less—Wear and Tear allowance for 1929-30	40
Profits available for set off against loss	260
Less—Loss brought forward ..	260
	Nil
Balance of loss available for carry forward	£240
Viz., loss brought forward from 1928-29	£500
Less—Applied 1929-30	260
Carry forward ..	£240

In effect, of course, the application of the loss will affect only five years, as the liability for the year of assessment following the trading year in which the loss occurred will be nil, and the loss will be applied till exhausted to reduce the assessable profits of the five succeeding years of assessment.

In the case of a partnership, the application of the loss against either (*a*) the profits of the same trade for the years in the six years' period during which the unexhausted loss may be applied in reduction of subsequent profits ; or (*b*) other income of the year of assessment in which the loss occurs for immediate relief under Section 34, Income Tax Act, 1918 ; or (*c*) the assessable profits in another trade for the year of assessment following the year of the loss (i.e. the year of assessment for which the liability in respect of the trade, &c., in which the loss was incurred would be nil) under Rule 13, Cases I and II, Schedule D, must be considered individually in the case of each partner and is taken to mean the share of the loss

allocated to the partner in terms of the Partnership Deed or Arrangement in relation to either—

(*a*) the partner's share of the profits assessment for any of the years of the six years period ; or

(*b*) the partner's share of the profits assessment for the year of claim under Section 34, together with his other personal income for the same year ; or

(*c*) the partner's share of the assessable profits for the year of claim under Rule 13.

Claims under (*b*) and (*c*) are separately considered in the chapter entitled " Claims."

A person sustaining a loss in the occupation of woodlands or lands and electing under Rule 7, Schedule B, to be assessed under Schedule D, has the same rights with regard to the carry forward of the loss as obtain in the case of a person carrying on a trade. It is provided, however, that if the person reverts to the Schedule B basis in any subsequent year, no deduction or set off in respect of a previous loss is to be made.

The foregoing provisions relating to losses apply for the first time to losses sustained in the trading year ending within 1926-27, i.e. the trading year which forms the basis of the assessment for 1927-28.

Again, where a person, in terms of Section 29 (3), Finance Act, 1926, has elected to be assessed on the average basis for 1927-28 and 1928-29, the provisions set out above (and incorporated in Section 33, Finance Act, 1926) do not apply to any loss sustained before 1928-29, i.e. in the trading year ending within 1928-29, which forms the basis of assessment without any option for 1929-30.

There are two further provisions regarding losses in Sections 28 and 29 of the Finance Act, 1927.

The purpose of Section 28 is to afford relief in the case of a business commenced after 6th April 1923. Where a loss

was incurred in the financial year 1924 or 1925 the change in the basis of assessment for 1927-28 would exclude either of those losses from operating in the calculation of the 1927-28 or 1928-29 liability, and, further, those losses are outside the scope of Section 33, Finance Act, 1926 (regarding the carry forward of losses), which applies only to losses incurred in the financial year 1926 and subsequent years. The section provides that a loss for 1924 may be allowed to the extent of one-third against the assessable profits for 1927-28, and a loss for 1925 to the extent of one-third against both the assessable profits for 1927-28 and 1928-29. The whole relief in respect of losses which would have applied under the old average system is thus secured. There are several conditions obtaining with regard to the granting of the relief and reference in this connection should be made to Section 28, Finance Act, 1927.

Section 29, Finance Act, 1927, extends the scope of Section 33, Finance Act, 1926 (which relates to the availability of losses for relief or carry forward against subsequent profits), to the losses incurred prior to the date of transfer in a business which is transferred from an individual or partnership to a company in exchange for shares in the company. The conditions required to be fulfilled before the section operates are :—

(1) The private owner of the business must have received either personally or through nominees shares in the company as the sole or principal consideration for the transfer of the business.

(2) The relief will only apply for the period during which the shares are retained by the previous owner or partner *and* the company continues to carry on the business. The allowance under this section is given to the individual shareholder who suffered the loss and is to be set off *only* against income derived from the company. This income may take the form of dividends, remuneration or interest. Further, the set-off is to be made

primarily against any income (i.e. income derived from the company) which is the subject of direct assessment, e.g. directors' or other remuneration, and *thereafter*, to the extent to which the relief due exceeds the income directly assessed, against other income derived from the company and from which tax was deductible, e.g. dividends, &c. For repayment purposes, a claim must be intimated not later than twelve months after the end of the year of assessment to which the claim relates. For any particular year of claim, the company must have carried on business *throughout* that year of assessment, and the previous proprietor must have held the shares for the same year. The relief also applies to the year in which the company is set up, the conditions operating, as regards that year only, from the date of the company's formation to the following 5th April.

EXAMPLES

I.—Trading year of the A.B.C. Co., Ltd., ends 31st December.

Adjusted profit, year to 31st Dec. 1926	£500
,, loss, year to 31st Dec. 1927	1,000
,, profit, year to 31st Dec. 1928	600
,, profit, year to 31st Dec. 1929	800
,, profit, year to 31st Dec. 1930	400

			Liability
1927-28—profit of preceding year		..	£500
1928-29—loss of preceding year	..	..	Nil
loss available for carry forward	£1,000		
1929-30—profit of preceding year	..	600	
Less part of loss carried forward	..	600	
		——	Nil
Balance of loss available for carry forward	..	1,000	

NOTE.—Under Section 19, Finance Act, 1928, any charge raised under Rule 21 of the General Rules for any year of assessment to recover tax deducted from annual payments is to be regarded as a "loss" incurred in that year and subject to the provisions regarding carry forward of losses contained in Section 33, Finance Act, 1926.

		Liability
Less applied 1929-30	£600	
	£400	
1930-31—profit of preceding year ..	£800	
Less balance of loss carried forward ..	400	
		400
1931-32—profit of preceding year		400

II.—Business owned by A. and B. in partnership, sharing profits in ratios as provided in the partnership deed and losses equally.

Trading year ends 30th September.

Adjusted profit, year to 30th Sept. 1926 ..	£450
,, loss, year to 30th Sept. 1927 ..	2,100
,, profit, year to 30th Sept. 1928 ..	600
,, profit, year to 30th Sept. 1929 ..	900
,, profit, year to 30th Sept. 1930 ..	1,200
,, profit, year to 30th Sept. 1931 ..	900
,, profit, year to 30th Sept. 1932 ..	1,500

	Liability	*Allocation*
1927-28—profit of preceding year ..	£450	A. £300
		B. £150
1928-29—Loss of preceding year	Nil	
Loss available for carry forward, £2,100		
		A. 1,050
		B. 1,050
1929-30—Profit of preceding year ..	600	
Allocation A.	£400	
Less part of loss carried forward	400	
	Nil	
Allocation B.	£200	

			Liability
Less part of loss carried forward	£200		
	Nil		Nil
Loss available for carry forward—			
(1) A. loss brought forward	£1,050		
Less applied 1929-30 ..	400		
Carry forward ..	£650		
(2) B. loss brought forward	£1,050		
Less applied 1929-30 ..	200		
Carry forward ..	£850		
1930-31—Profit of preceding year..		£900	
Allocation A.	£600		
Less part of loss carried forward	600		
	Nil		
Allocation B.	£300		
Less part of loss carried forward	300		
	Nil		Nil
Loss available for carry forward—			
(1) A. loss brought forward	£650		
Less applied 1930-31 ..	600		
Carry forward ..	£50		
(2) B. loss brought forward	£850		

Less applied 1930-31 ..	£300			
Carry forward ..	£550			
1931-32—Profit of preceding year ..		£1,200		
Allocation A.	£800			
Less loss carried forward	50			
	£750			
Allocation B.	£400			
Less part of loss carried forward	400		*Liability*	*Allocation*
	Nil		£750 A.	£750
			B.	Nil
Loss available for carry forward—				
(1) A.	Nil			
(2) B. loss brought forward	550			
Less applied, 1931-32 ..	400			
Carry forward ..	£150			
1932-33—Profit of preceding year ..		£900		
Allocation A.	£600			
Less loss carried forward	Nil			
	£600			
Allocation B.	£300			
Less loss carried forward	150			
	£150		£750	A. £600
				B. £150
1933-34—Profit of preceding year			£1,500	A. 1,000
				B. £500

III.—Business carried on by A. and B. in partnership sharing profits and losses equally. On 30th September 1930 B. retires and A. retains the business as sole proprietor.

Trading year ends 31st December—

Adjusted profit, year to 31st Dec. 1926	£1,200
,, loss to 31st Dec. 1927	.. 2,000
,, profit, year to 31st Dec. 1928	.. 800
,, profit, year to 31st Dec. 1929	.. 1,600
,, profit, year to 31st Dec. 1930	.. 500

		Liability	*Allocation*
1927-28—Profit of preceding year	.. £1,200		A. £600 B. £600
1928-29—Loss of preceding year	.. £2,000	Nil	
Loss available for carry forward—			
A.	£1,000		
B.	1,000		
1929-30—Profit of preceding year	.. £800		
Allocation A.	£400		
Less part of loss carried forward	400		
	Nil		
Allocation B.	£400		
Less part of loss carried forward	400		
	Nil	Nil	
Loss available for carry forward—			
(1) A. loss brought forward	£1,000		
Less applied 1929-30 ..	400		
Carry forward ..	£600		

		Liability Allocation
(2) B. loss brought forward	£1,000	
Less applied 1929-30 ..	400	
Carry forward ..	£600	
1930-31—Profit of preceding year	£1,600	
Apportioned—		
(1) A. and B., 6 months to 30th Sept. 1930 ..	£800	
(2) A. sole partner, 6 months to 5th April 1931	800	
Allocation, A. $\frac{1}{2} \times 800$ =	£400	
Plus	800	
	£1,200	
Less loss carried forward	600	
	£600	
Allocation, B. $\frac{1}{2} \times 800$ =	£400	
Less part of loss carried forward	400	
	Nil	
		£600 A. 600 B. Nil
Loss available for carry forward—		
(1) A. loss brought forward	£600	
Less applied 1930-31 ..	600	
	Nil	
(2) B. loss brought forward	£600	
Less applied 1930-31 ..	400	
	£200	

	Liability	*Allocation*
Note.—As B. retired 30th Sept. 1930, the unexhausted balance of B.'s share of the original loss, viz. £200, drops and is not available for setting off against A.'s future assessable profits.		
		A. sole partner
1931-32—Profit of preceding year ..	£500	£500

TRANSFER OF BUSINESS

The procedure with regard to the liability of a business, &c., changing hands is considerably simplified by the Finance Act, 1926.

Hitherto the complications attendant upon Rule 11 of Cases I and II, Schedule D, Income Tax Act, 1918, and the determination of whether or not there was a specific cause operating to reduce the profits of a successor to a business and to entitle the latter to an adjustment of the continuous average in terms of the actual profits from the date of change in proprietorship, gave rise to considerable difficulty in the administration of that section of the Act. From 1928-29, however, the provisions of Section 32 of the Finance Act, 1926 (which replaces Rule 11 of the Rules applicable to Cases I and II, Schedule D), apply in those cases where changes in proprietorship of businesses occur after 6th April 1928.

The section—which is obviously designed to avoid the difficulties and anomalies which arose under the old Rule 11—establishes a definite treatment of all businesses, &c., in which a change in proprietorship occurs.

Where the change in proprietorship of a business is only partial, the liability on the normal basis, viz. the profits of the preceding year, is not interrupted, unless all parties concerned (predecessors and successors) prefer to be

treated for Income Tax purposes as though the business had been discontinued by the predecessors and a new business commenced by the successors at the date of change. It should be noted that no conditions with regard to fluctuations of profits, &c., either in the period preceding the change or in the period subsequent thereto require to be fulfilled.

In order to have the liability in respect of the business profits treated as that of a business discontinued by the predecessors and of a new business commenced by the successors, it is only necessary that an application for this treatment should be furnished within three months after the change takes place in writing to the Inspector and signed by all parties, viz. the predecessors and the successors, or, where any of the persons involved in the change has died in the meantime, by the representatives of such deceased person. It follows, therefore, that mutual agreement to this method of treatment is required on the part of both predecessors and successors.

Businesses, &c., in which changes of proprietorship will be partial comprise the following :—

(*a*) A partnership in which a change occurs by reason of the death or retirement from the partnership of one or more partners, or the admission of a new partner in such circumstances that there is some element of continuity between the old and the new partnerships, viz. one or more of the partners in the old firm continue to be partners in the new firm.

(*b*) The case of a sole proprietor becoming a partner in a partnership, or, conversely, a partnership being dissolved and the business passing to a sole proprietor who was previously a partner in the partnership.

It should also be noted that if the option of treatment as a discontinued and new business to the predecessors and

successors respectively is claimed, the provisions in force with regard to the computation of the Income Tax liability of new and discontinued businesses take effect as explained earlier in this chapter.

The reason, therefore, for the delay in the application of this section until 1928-29 is probably due to the fact that the right to revise the assessments of the penultimate year of a business discontinued does not apply to any year earlier than 1927-28. The inducement, therefore, to effect a merely nominal change in proprietorship during 1927-28 with intent to avoid liability on the profits of 1926-27, where that year resulted in large profits, is thus defeated. In the case of a business the proprietorship of which changed during 1927-28, and where the successor under the provisions of Rule 11, Cases I and II, Schedule D, which remains in force for 1927-28, obtains adjustment of the assessment or his portion thereof for that year by reason of a specific cause claim (i.e. on proof of the profits falling off owing to a specific cause operating since or by reason of the change), the successor may claim on written application not later than 5th October 1929 to have the business treated as new from the date of change for purposes of computing the assessment for 1928-29.

In cases where the personnel of a partnership has changed and no claim is made to have the business treated as discontinued and newly set up at the date of change, any unexhausted losses incurred not earlier than 1926-27 personal to a partner leaving the partnership are eliminated in the computation of future liabilities.

Where a claim is made and the liability is adjusted on the lines of a business discontinued and newly set up at the date of change, all unexhausted losses from previous years are, of course, ignored in computing the liability of the successors.

Where, in spite of the change in the proprietorship of a business, the latter is treated as a continuing business in the hands of the successor, wear and tear allowance to the successor, if claimed, is calculated on the value of the plant and machinery as written down for Income Tax purposes, and any unexhausted balance of wear and tear due to the predecessor may be carried forward by the successor.

Where a business is treated as new in the hands of the successor, wear and tear allowance falls to be calculated on the cost to the successor of the plant and machinery. The cost figure will require to be carefully scrutinised if it is much in excess of the written-down value of the plant and machinery which operated for allowance to the predecessor with a view to ascertaining whether

(*a*) there is a substantial element of identity between the old and new owner ; or

(*b*) the cost of the Plant and Machinery to the successor is based on a figure inclusive of the value of Goodwill and Assets other than Plant and Machinery which do not operate for Wear and Tear allowance.

CHANGE IN PROPRIETORSHIP OF A BUSINESS

EXAMPLE I

Business owned by A. and B. in partnership to 31st December 1929 at which date it is taken over by B. and C. (B. being a partner common to both partnerships). Profits as adjusted for Income Tax purposes :—

Year to 31st December	1927	.. .. ..	£1,200
,, ,,	1928	.. .. ..	1,400
,, ,,	1929	.. .. ..	1,600
,, ,,	1930	.. .. ..	1,000

Claim is made within three months of the date of change to have the business treated as discontinued by the partnership A. and B. and newly set up by the partnership B. and C. as at 31st December 1929.

Liability as assessable—

1928-29—Profits of preceding year	.. ..	£1,200
1929-30 „ „	.. ..	1,400

In view of the claim, the liability will be adjusted as follows :—

A.—Year of change, 1929-30, assessment £1,400

For this assessment will be substituted—

(1) *To the partners A. and B. :*

Actual profits from 6th April 1929 to 31st December 1929, say nine months = $\frac{9}{12} \times 1{,}600$ £1,200

(2) *To the successors, B. and C.:*

Actual profits from 1st January 1930 to 5th April 1930, say three months = $\frac{1}{4} \times 1{,}000$ 250

B.—For the year 1928-29 (the year preceding the year of discontinuance by A. and B.)—

Profits as assessed	.. ..	£1,200
Actual profits of year to 5th April 1929 :		
6th April 1928 to 31st December 1928, say nine months = $\frac{9}{12} \times 1{,}400$	.. ..	1,050
1st January 1929 to 5th April 1929, say three months = $\frac{3}{12} \times 1{,}600$	.. ..	400
		£1,450

An additional assessment will therefore be raised on A. and B. for 1928-29 to bring into charge the excess of the actual over the assessed profits of that year, viz. £250 (£1,450−£1,200).

C.—Assessment, 1930-31, on successor—actual profit of trading year from date of commencement £1,000

D.—Assessment, 1931-32, on successor—profit preceding year 1,000

EXAMPLE II

Business carried on by X. and Y. until 30th September 1929, when Y. dies and X. carries on the business from that date as sole proprietor.

No claim is made to have the business treated as discontinued at 30th September 1929 by X. and Y. and newly set up by X.

Profits adjusted for Income Tax purposes :—

Year to 31st March 1928 .. .. .. £800
,, ,, 1929 1,400
,, ,, 1930 1,500

Liability 1929-30 as assessed would be apportioned under Rule (9), Cases I and II, Schedule D, as follows :—

(*a*) To firm X. and Y., from 6th April 1929 to 30th September 1929, say six months, = $\frac{1}{2} \times 1{,}400$ £700

Allocable to X. and Y. according to their share of profits in that period.

(*b*) To X., sole proprietor, 1st October 1929 to 5th April 1930, say six months, = $\frac{1}{2} \times 1{,}400$ £700

Liability, 1930-31—Profits of preceding year.. £1,500

CHAPTER XIII

PARTNERSHIPS & LIMITED COMPANIES

When once the amount of the liability for assessment under any Schedule or Case has been ascertained, the assessment itself is carried out with reference to the circumstances of the taxpayer on whom the liability falls.

It is well to remember, however, that in the case of a trading concern, &c., the assessment arises on the business profits independent of the destination of the profits. This explains why the profits assessment in those cases where the business belongs to (*a*) a Limited Company, and (*b*) a Firm or Partnership is raised in the case of (*a*) on the Limited Company and (*b*) on the Firm or Partnership in the business name. In the case of the former, the person legally responsible for the discharge of all duties devolving on the taxpayer in connection with the Income Tax liability of the business profits (e.g. rendering of accounts, completion of return of *business* income, &c.) is the secretary, and, in the case of the latter, the precedent acting partner. In the case of a partnership, the business profits cannot be separately assessed on the individual

partners according to their individual shares. At the same time, however, the actual amount of tax payable on the assessed profits of a partnership concern is calculated with reference to (*a*) the individual shares of the profits to which the several partners are entitled, and (*b*) the allowances and reliefs which the partners, as individuals, may claim in accordance with their total statutory incomes, returns of which must be made by the individual partners themselves and which will, in turn, include their respective shares of the firm's assessed profit for the year. The method in which the assessable profit of the business falls to be allocated between the partners takes account of the circumstances which govern their shares of the *business* profits arising *during* the year of assessment, which, of course, may or may not be the same as those which applied to the profits of the year upon which the assessment is calculated.

Thus, if during the year the profits of which form the basis of liability, a partnership consisted of two partners, and if, during the year of assessment, the firm is composed of three partners, the actual liability in respect of the business profits for the year of assessment falls to be allocated between the three partners according to the manner in which they share the business profits *during that period.*

Again, if *during* the year of assessment the constitution of a partnership is changed either by the retiral of one or more partners, or by the assumption of one or more new partners—in such a way, however, that one or more partners of the old firm remain partners in the new firm—the liability of the year of assessment falls to be allocated (*a*) proportionately between the old and the new partnership on a time basis having regard to the date of the change, and (*b*) with regard to each proportion of the assessment so allocated, according to the individual

circumstances of the several partners participating therein. Neither the basis of liability itself, nor the amount of *assessed liability* for any Income Tax year, is affected by a change of partnership or a change of ownership where the business itself simply changes hands as a going concern and there is an element of continuity in the personnel of the business. It is open, as explained in the previous chapter, to the successors and predecessors to claim jointly to have the business treated as discontinued by the predecessor and continued by the successor, if notice is given within three months of the date of change.

Any liability, whether in respect of business profits or other sources of income, which falls to be assessed on a limited company, is charged at the full standard rate of tax, and in no circumstances is any part of the profits assessed on a limited company regarded as earned income subject to earned income relief. The question of personal allowances and reliefs, therefore, does not arise in connection with the liability of a limited company or similar body.

The examples which follow will illustrate the manner in which profits assessments are allocated between partners of a firm, and how the various allowances to which partners are entitled, are given from their respective shares of the assessment.

The actual allocation of the amount of the profits assessment between the partners depends upon the manner in which trading profits are shared by them during the year of assessment. Such shares are usually comprised of three elements, viz. :—

(*a*) *Interest on Capital.*

Usually calculated at a fixed rate per cent. on the balances of partners' Capital Accounts at the date of the last Balance Sheet. The amount to be taken into account

in the allocation of the profits assessment, is the interest payable to each partner during the year of assessment. In practice it is usual to adopt the amount of interest payable for the trading year ending within the year of assessment.

(*b*) *Salaries.*

These are usually payable to partners in agreed amounts according to the provisions of the partnership deed.

(*c*) *Actual Share of Profits.*

The profits remaining after payment of Interest on Capital and Partners' Salaries (which are regarded as a first charge on the profits) are usually divisible among the partners in ratios fixed by the partnership agreement.

For allocation purposes the ratios taken are those in force during the year of assessment, or, as adopted for practical purposes, during the financial year ending within the year of assessment.

Where the partnership deed does not provide for the payment of interest on partners' capital or partners' salaries, the allocation of assessed profits is simplified, and is carried out on the basis of the shares of business profits to which partners are entitled during the year of assessment.

Where the profits of the business are subject to first charges such as annuities or any other annual payments (which should, of course, be made under deduction for tax) or where there are specific charges like loan interest, royalties, &c. (also payable under deduction for tax) secured on the business assets, and arising in the *business* and not upon any of the partners as individuals, or further, where there is an excess of charges or burdens (payable by the *firm*) over the statutory income from the subjects on which the charges are secured (e.g. where the

total amount of Ground Rents, Feu Duty, Mortgage or Bond Interest, &c., payable in respect of property owned by the firm is greater than the business income other than trading profits, i.e. net Schedule A of property, Case III Interest, Investment Income, &c.) such amounts fall to be deducted from the assessed figure of profits in order to arrive at the amount of assessable profits to be allocated among the partners. Having allocated the balance between the partners, the amount of the " charges " deducted must be added to the net amount, if any, chargeable at the full standard rate of tax (this being to cover the tax deducted from such " charges " at the time of payment).

It should be noted that the amount of any depreciation allowance (which is effected by a deduction in the assessment itself from the assessed profit) should be deducted from the amount of the assessment in order to arrive at the balance to be allocated among partners.

EXAMPLE I

The Case I assessment of the firm of A. B. C. & Co. for the year 1927-28 was £1,200, and the firm consisted of two partners, A. and B., sharing profits for 1927-28 as follows :

—	*Salary*	*Interest on Capital*	*Share of Balance*
	£	£	
A.	250	60	$\frac{3}{4}$
B.	200	50	$\frac{1}{4}$

The firm pays no charges for the year 1927-28. Each partner has made a return of total income and is entitled to the following allowances :—

—	*E.I.R.*	*P.A.*	*Ch.*	*D.R.*	*R.R.*	*L.A.*
	£	£	£	£	£	£
A.	—	225	63	—	225	15 (Policy post June 1916.)
B.	—	135	—	25	225	—

Show how the firm assessment would be carried out, and calculate the amount of tax payable by each partner.

Amount of assessed profits for 1927-28..			£1,200
Deduct—			
(*a*) Partners' Salaries—A. ..	£250		
B. ..	200		
		£450	
(*b*) Interest on Capital—A. ..	60		
B. ..	50		
		110	
			560
Balance			£640

Allocation between Partners

—	*Salary*	*Interest*	*Share of Balance*	*Total*
	£	£	£	£
A.	250	60	$\frac{3}{4}$ = 480	790
B.	200	50	$\frac{1}{4}$ = 160	410
	£450	£110	£640	£1,200

Calculation of tax payable on assessment of £1,200 :—

—	A.	B.	*Total*
Share	£790	£410	£1,200
E.I.R.	132	68	200
P.A.	225	135	360
Ch.	63	—	63
D.R.	—	25	25
Total Deductions	420	228	648
Balance	370	182	552
Chargeable ..	225 @ 2/– 145 @ 4/–	182 @ 2/–	407 @ 2/– 145 @ 4/–
Tax	51 10 0	18 4 0	69 14 0
L.A.	15 @ 2/– 1 10 0	—	1 10 0
Net Tax Payable	50 0 0	18 4 0	£68 4 0

The actual assessment as shown on the Assessment Notice to the Firm would be carried out as follows :—

Profits		£1,200	
Less E.I.R.	£200		
P.A.	360		
Ch.	63		
D.R.	25		
	648		
407 @ 2/– 145 @ 4/–			£69 14 0
Less : L.A.		15 @ 2/–	1 10 0
Net Tax payable			£68 4 0

The total tax payable, viz. £68 4s. 0d., would be borne—

By A.	.. ..	.. £50 0 0	as above.
By B.	.. ..	.. 18 4 0	,, ,,

EXAMPLE II

The firm of A. B. C. & Co. consists of three partners, A., B., C., sharing profits for the year of assessment 1928-29 as follows :—

—	*Salary*	*Interest*	*Share of Balance*
	£	£	
A. ..	400	150	⅓
B. ..	300	100	⅓
C. ..	200	50	⅓

The assessable profits of the firm for 1928-29 are £3,270 and the firm pays charges as follows :—

Annuity to retired partner	£250
Loan Interest (gross)	500
Total	£750

Depreciation allowance for 1928-29 is £120.

The individual Returns of Partners show that they are entitled to the following allowances :—

—	*E.I.R.*	*P.A.*	*Ch.*	*D.R.*	*R.R.*	*L.A.*
	£	£	£	£	£	£
A. ..	—	225	110	—	225	45 (post June 1916)
B. ..	—	225	60	25	225	—
C. ..	—	135	—	25	225	10 (post June 1916)

Calculate the amount of tax payable in the firm's assessment for 1928-29, and show how much would be paid by each partner.

Firm assessment as above		£3,270
Less Depreciation		120
		£3,150
Deduct Charges :—		
Annuity	£250	
Loan Interest	500	
		750
To be allocated among Partners.. ..		£2,400

Divisible among partners as follows :—

—	*Salary*	*Interest*	*Share of Balance*	*Total*
	£	£	£	£
A.	400	150	$\frac{1}{3}$ = 400	950
B.	300	100	$\frac{1}{3}$ = 400	800
C.	200	50	$\frac{1}{3}$ = 400	650
	£900	£300	£1,200	£2,400

Tax payable as follows :—

—	A.	B.	C.	*Total*
Share	£950	£800	£650	£2,400
E.I.R.	158	133	108	399
P.A.	225	225	135	585
Ch.	110	60	—	170
D.R.	—	25	25	50
Total Allowances	493	443	268	1,204
Balance	457	357	382	1,196
Chargeable ..	225@2/-	225@2/-	225@2/-	675@2/-
	232@4/-	132@4/-	157@4/-	521@4/-
Tax	68 18 0	48 18 0	53 18 0	—
Relief L.A. ..	4 10 0	—	1 0 0	—
	(45@2/-)		(10@2/-)	
Net Tax Payable	64 8 0	48 18 0	52 18 0	166 4 0
Add Charges £750 at 4/-				150 0 0
Total Tax payable in Firm Assessment ..				316 4 0

The tax payable in the Firm Assessment, viz. £316 4s. 0d., will be accounted for as follows :—

	£	s	d
By A.	64	8	0
By B.	48	18	0
By C.	52	18	0
By Firm in respect of charges	150	0	0
	£316	4	0

The gross amount of the firm assessment, viz. £3,270, may be reconciled as follows :—

Gross		£3,270
Depreciation	£120	
Total E.I.R.	399	
,, P.A.	585	
,, Ch.	170	
,, D.R.	50	
,, chargeable at R.R.	675	
(Partners) chargeable at Standard Rate	521	
Charges chargeable at Standard Rate ..	750	
	£3,270	

EXAMPLE III

The profits assessment under Case I of Schedule D for 1928-29 on the firm of X. Y. Z. & Co. is £2,245—depreciation allowance £15. The firm also owns property the net Schedule A of which, for 1928-29, is £250 and on which the following charges arise :—

Mortgage Interest (gross)	£250
Ground Annual	20
	£270

At 6th April 1928 the firm consisted of two partners, X. and Y., who had no income other than that arising from the business and who were entitled to allowances as follows :—

—	*E.I.R.*	*P.A.*	*Ch.*	*R.R.*	*L.A.*
	£	£	£	£	£
X. ..	—	225	60	225	50 (20 pre June 1916)
Y. ..	—	135	—	225	15 (post June 1916)

X. and Y. shared profits as follows for 1928-29 :—

—	*Salary*	*Interest*	*Share of Balance*
	£	£	
X. ..	200	80	⅔
Y. ..	150	40	⅓

On the 1st of January 1929 a new partner, Z., is assumed and, according to the revised partnership agreement, the distribution of profits is to be as follows :—

—	*Salary*	*Interest*	*Share of Balance*
	£	£	
X. ..	200	80 (as before)	⅓
Y. ..	150	40 ,,	⅓
Z. ..	100	200 (4,000 @ 5%)	⅓

No application is made by the predecessor firm X. Y. and the successor firm X. Y. and Z. to have the business treated as discontinued at 1st January 1929 by X. and Y. and a new business commenced at that date by X., Y., and Z.

Prior to his assumption as a partner, Z. is a salaried employee of the firm and is assessed for 1928-29 under Schedule E. He is entitled to allowances as follows :—

E.I.R.—P.A., £225 ; Ch. £60 ; and R.R., £225.

His liability under Schedule E is revised to correspond with the salary earned from 6th April 1928 to the date of cessation as employee and is amended to the following :—

Gross Schedule E Assessment		£200
E.I.R.	£33	
P.A.	167	No duty payable.

He has no other income beyond that from the business. It is required to show :—

(*a*) The tax payable on the liability of X. Y. Z. & Co. for 1928-29 as originally assessed, with the amount of tax payable by each partner ; and

(*b*) The tax payable on the liability of X. Y. Z. & Co. for 1928-29 as revised on account of the introduction of the new partner, with the amount of tax payable by each partner.

1928-29—Liability as originally assessed	£2,245
Less : Depreciation	15
	£2,230

N.B.—There are excess charges arising on the property owned by the firm to the extent of £20 (viz. £270 *less* net Schedule A £250), and these will require to be kept in charge in the Case I assessment and will affect the amount on which E.I.R. is allowable.

Deduct excess charges	20
To be allocated between partners ..	£2,210

Divisible between partners as follows :—

—	*Salary*	*Interest*	*Share of Balance*	*Total*
	£	£	£	£
X. ..	200	80	⅔ = 1,160	1,440
Y. ..	150	40	⅓ = 580	770
	£350	£120	£1,740	£2,210

Tax payable as follows :—

—	X.	Y.	*Total*
	£	£	£
Share	1,440	770	2,210
E.I.R.	240	128	368
P.A.	225	135	360
Ch.	60	—	60
D.R.	—	—	—
Total Allowances	525	263	788
Balance	915	507	1,422
Chargeable ..	225 @ 2/-	225 @ 2/-	—
	690 @ 4/-	282 @ 4/-	—
Tax	160 10 0	78 18 0	—
Relief L.A. ..	6 0 0	1 10 0	—
	(20 @ 3/-)	(15 @ 2/-)	
	(30 @ 2/-)		
Net Tax Payable	154 10 0	77 8 0	231 18 0
Add: Excess Charges 20 @ 4/- ..			4 0 0
Total Tax payable in Firm Assessment			£235 18 0

The above tax of £235 18s. is payable as follows :—

By X.	£154 10 0
By Y.	77 8 0
By X.Y.Z. & Co. (for charges)	4 0 0
	£235 18 0

As a result of the introduction of the new partner, Z., as from 1st January 1929, the liability under Case I for 1928-29 falls to be revised as follows :—

(*a*) The liability itself requires to be apportioned, on a time basis, between the old firm of X. Y. Z. & Co. (two partners) from 6th April 1928 to 31st December 1928, say, nine months, and the new firm of X. Y. Z. & Co. (three partners) from 1st January 1929 to 5th April 1929, say, three months ; and

(*b*) Partners' shares of the revised allocation require to be recast.

Taking the steps of the revision in turn the adjustments are carried out as follows :—

(*a*) Liability as originally assessed	£2,245
Less : Depreciation	15
	2,230
Deduct Excess charges as before	20
	£2,210

Allocable between old firm X. Y. Z. & Co., and new firm X. Y. Z. & Co. :—

(*a*) X. Y. Z. & Co. (2 partners), 9 months to 31st December 1928 = ¾ of £2,210	£1,658
(*b*) X. Y. Z. & Co. (3 partners), 3 months to 31st March 1929 = ¼ of £2,210	552
	£2,210

(1) £1,658 liability of X. Y. Z. & Co. (old) divisible as follows between partners :—

—	*Salary (for 9 mths)*	*Interest (for 9 mths)*	*Share of Balance*	*Total*
	£	£	£	£
X. ..	150	60	$\frac{2}{3}$ = 871	1,081
Y. ..	112	30	$\frac{1}{3}$ = 435	577
	£262	£90	£1,306	£1,658

Tax payable thereon as follows :—

—	X.	Y.	*Total*
Share	£1,081	£577	£1,658
E.I.R.	180	96	276
P.A.	225	135	360
Ch.	60	—	60
Total Deductions	465	231	696
Balance	616	346	962
Chargeable ..	225 @ 2/– 391 @ 4/–	225 @ 2/– 121 @ 4/–	— —
Tax	100 14 0	46 14 0	—
Relief for L.A. ..	6 0 0 (20 @ 3/–) (30 @ 2/–)	1 10 0 (15 @ 2/–)	— —
Net Tax Payable	94 14 0	45 4 0	139 18 0
Tax payable by X. and Y.			£139 18 0

(2) £552 liability of X. Y. Z. (new) divisible between partners as follows :—

—	*Salary (for 3 mths)*	*Interest (for 3 mths)*	*Share of Balance*	*Total*
X.	£50	£20	$\frac{1}{3}$ = £120	£190
Y.	38	10	$\frac{1}{3}$ = 119	167
Z.	25	50	$\frac{1}{3}$ = 120	195
	£113	£80	£359	£552

Tax payable as follows :—

—	**X.**	**Y.**	**Z.**	*Total*
Share	£190	£167	£195	£552
E.I.R.	32	28	32	92
P.A.	—	—	58	58
Ch.	—	—	60	60
Total Deductions	32	28	150	210
Balance	158	139	45	342
Chargeable ..	158@4/–	139@4/–	45@2/–	—
Tax	31 12 0	27 16 0	4 10 0	—
Relief for L.A. ..	—	—	—	—
Net Tax Payable	31 12 0	27 16 0	4 10 0	£63 18 0

Total Tax payable by partners of old and new firm of X. Y. Z. & Co. (Tax as above, £139 18s. 0d. + £63 18s. 0d.) ..	203 16 0
Add: Tax payable on Excess Charges 20@4/–	4 0 0
Total Tax payable on revised liability for 1928-29.	£207 16 0

It will be seen, therefore, that in consequence of the adjustment of the liability for 1928-29 to give effect to the change of circumstances brought about by the entry of the new partner during the year of assessment, the total tax payable is £207 16s. 0d., as against £235 18s. 0d. in the original assessment as computed with regard to the circumstances in force at the time when the assessment was made.

The difference in the amount of tax payable, viz. £28 2s. 0d. (£235 18s. 0d. *less* £207 16s. 0d.) would fall to be discharged or repaid, according as to whether or not the tax in the original assessment had been paid.

EXAMPLE IV

The firm of A. & B. (partners A. and B.) was converted at 5th October 1928 into a limited company. The liability under Case I for 1928-29 assessed on the firm of A. & B. was £2,200, less depreciation £120.

The partners shared profits for the year of assessment as follows :—

—	*Salary*	*Interest*	*Share of Balance*
	£	£	
A.	800	100	½
B.	700	80	½

The individual Returns of partners show them to be entitled to the following allowances and reliefs :—

—	*E.I.R.*	*P.A.*	*Ch.*	*R.R.*
	£	£	£	£
A.	—	225	60	225
B.	—	135	—	225

Calculate the amount of tax payable (*a*) by the firm ; and (*b*) by the limited company for the year of assessment 1928-29.

Assessable profits as above	£2,200
Less : Depreciation	120
	£2,080

Divisible between the firm of A. & B. and the limited company on a time basis as follows :—

Firm—from 6th April 1928 to 4th October 1928 (say 6 months) = ½ of £2,080	£1,040
Limited Company—from 5th October 1928 to 5th April 1929 (say 6 months) = ½ of £2,080 ..	£1,040
	£2,080

Tax payable as follows :—

(*a*) By the firm :—

Share of liability as above £1,040

Divisible between partners as follows :—

—	*Salary* (6 *mths.*)	*Interest* (6 *mths.*)	*Share of Balance*	*Total*
	£	£	£	£
A.	400	50	½=100	550
B.	350	40	½=100	490
	£750	£90	£200	£1,040

Tax payable thereon :—

—	A.	B.	*Tax*
Share	£550	£490	—
E.I.R.	92	82	—
P.A.	225	135	—
Ch.	60	—	—
Total Deductions	377	217	—
Balance	173	273	—
Chargeable ..	173 @ 2/–	225 @ 2/–	—
		48 @ 4/–	—
Tax Payable ..	17 6 0	32 2 0	49 8 0
(*b*) By the Limited Company :— Share of liability as above, £1,040 @ 4/–			208 0 0
Total Tax payable on Assessment ..			£257 8 0

CHAPTER XIV

CLAIMS

Section 34 *and Rule* 13

There now fall to be considered the reliefs which a taxpayer is entitled to claim in the following circumstances :—

(*a*) Where a loss is made in a trade, profession, or vocation.

(*b*) Where two or more *distinct* trades are carried on and assessable according to the Rules applicable to Cases I or II of Schedule D, and a loss is made in one or other of the trades, and a profit in the other(s).

LOSS CLAIMS—SECTION 34 INCOME TAX ACT, 1918

It has already been pointed out that the *legal* or *statutory* income from any trade, profession, &c., for any year of assessment is the amount of the *assessed* profits for that year. This statutory income is based on the trading results of the year prior to the year of assessment (a departure from this basis will occur in the case of new businesses, and the right of election to the average basis for 1927-28 and 1928-29), and consequently takes no cognisance of the actual results of the trading year ending within the year

of assessment, which would, of course, indicate the actual income for that period from the particular source which is the subject of assessment.

Where, after the necessary adjustments for Income Tax, the accounts of the preceding year show a loss, the assessable income is regarded as nil—that is to say, the Revenue does not recognise a negative amount of income from any source for assessment purposes, e.g. :—

Year to 31st December 1927—Loss adjusted for Income Tax	£600
Liability, 1928-29	Nil

It is, however, provided by the Income Tax Act, 1918—Section 34—that where a loss is made *in the Income Tax year*, immediate relief can be sought in respect of the loss by application to have the amount of the loss set off against the statutory income of the year of assessment in which the loss arises. The total amount of the loss available for carry forward (see chapter on " Basis of Assessment ") is reduced by the amount on which relief is granted.

In connection with applications for relief in respect of a loss arising in the year of assessment, the following important points should be noted :—

The loss in respect of which relief may be claimed must arise in connection with one of the following :—

(*a*) *Any trade, profession or vocation.*

(*b*) The occupation of lands *for the purposes of husbandry only*. (Normally these are assessable under Schedule B.)

(*c*) *Woodlands*, in respect of which an application has been made to be assessed under Schedule D.

It should be noted that the relief is to be claimed by way of *application in writing* to the Inspector of Taxes, within

twelve months after the end of the year of assessment concerned, and the relief may be granted by the General or Special Commissioners at the taxpayer's request. In practice, of course, the relief is granted by the Inspector and only where the amount of the loss cannot be agreed with the Inspector of Taxes is the personal appearance of the taxpayer before the Commissioners necessary. It should be noted, further, that the section authorising the relief provides for an *application* only, and as the latter is not considered to be an *appeal* against the legal liability of the year of assessment, no appeal can be made against the determination of the Commissioners in connection with the application for relief.

The amount of the loss having been ascertained in the usual way from the Financial Accounts, the next procedure is to set off the amount of the loss so ascertained against the statutory income from all sources.

Theoretically, the section provides for relief to be given by way of repayment (i.e. on the assumption that all tax has already been paid on the total statutory income of the year of assessment), but in practice, where any tax remains unpaid at the date of lodging the claim for relief, the latter will be given as far as possible by way of discharge of the tax outstanding.

In connection with a claim for relief in respect of loss a statement of total statutory income for the year of assessment for which the claim is made is called for, and the production of receipts or vouchers for Income Tax paid on the statutory income against which the amount of the loss is claimed to be set off.

Such a statement of total statutory income should include the *legal* income from every source held by the taxpayer and will include, therefore, the *assessment* for the year on

the trade, &c., in which the loss arises. The only exception in this respect occurs in the case of a farmer occupying lands for purposes of husbandry only ; in this case, if a loss arises in the year of assessment, the amount of the Schedule B assessment is considered to be *nil*, and the loss is available for set-off against other income. (See Example later.)

Claims may be made where the loss occurs in any trade, &c., as already indicated, but it should be noted that where the trade, &c., is carried on by a partnership the claim *cannot* be made in respect of the total loss by the *firm*, but must be made by each partner separately, to have the amount of his share of the firm's loss set off against his *individual* aggregate income (which, of course, will include his *share* of the firm's assessment for the year of the claim).

A shareholder of a company is not entitled to claim in respect of his portion of the company's loss.

Further, claims to relief in respect of trading losses are not admissible in the case of undertakings which are in the nature of " foreign possessions," and assessable under Case V of Schedule D, or in the case of trading losses sustained by bodies which are granted statutory exemption from tax under Schedule D, e.g. Industrial and Provident Societies, Co-operative Societies, &c.

In arriving at the amount of the loss available for relief for any year of assessment, it is permissible to add to the amount of the adjusted loss as shown by the accounts, the amount of the depreciation allowance (if any) for the year of assessment for which the claim is made.

Where a person has been granted relief in respect of loss for any year of assessment, the amount of the loss upon which relief has been granted must be excluded in the computa-

tion of his liability for any subsequent year of assessment. It should be noted, however, that the section provides for the exclusion from future computations of the amount of the loss upon which relief has been granted *in the case of the person to whom the relief has been granted.* It follows, therefore, that if the person claiming the relief is succeeded in the business in which the loss arose, and no application is made to have the business treated as new from the date of succession, the liability of the *successor* is to be based on the income of the preceding year without any reduction or adjustment on account of the relief given to the predecessor.

The amount of the loss for the year of claim is normally taken to be the amount (after adjustment for Income Tax purposes) shown by the Financial Accounts for the *ordinary trading year* ending within the year of assessment. Where, for some particular reason (e.g. in the case of a new business, or where accounts have not been made up at regular intervals of twelve months), the principle of splitting accounts in order to arrive at the actual trading results of the twelve months between 6th April one year and 5th April following, is conceded, the taxpayer concerned will be required to give an undertaking to agree to a similar apportionment in dealing with similar claims for succeeding years.

It should be remembered that where an *individual* lodges a claim for relief in respect of loss and has the amount of the loss set off against his aggregate statutory income, the effect of the claim is to reduce his aggregate statutory income by the amount of the loss on which relief is granted, and he may, therefore, become entitled, by reference to the revised amount of his aggregate statutory income, to further allowances and reliefs, where the latter had been given to any extent from the income out of which the relief in respect of the loss was granted.

In the case of individuals, relief in respect of loss is given primarily from sources of earned income ; where the latter is not sufficient to cover the amount of the loss available for relief, any balance is given against unearned or investment income.

The following examples will illustrate the manner in which relief in respect of a trading loss is carried out :—

EXAMPLE I

The trading results of the A.B.C.Co., Ltd., are as follows :—

Year to 30th September—

1926—Profit	£8,000
1927—Loss	£6,000
1928—Profit	£10,000
1929—Profit	£10,000

For 1927-28 the Case I assessment on the company was £8,000 (profits of the preceding year to 30th September 1926).

For the same year it was assessed under Schedule A for property owned £500 net. Charges payable for 1927-28 were £200.

A claim to relief in respect of the loss for the trading year to 30th September 1927, viz. £6,000, was made for the year 1927-28.

The aggregate statutory income for 1927-28 was as follows :—

	£	
Case I assessment ..	8,000	These would be the figures to be entered on the claim form (R79).
Schedule A assessment, net	500	
	£8,500	
Less Charges	200	
Net statutory income .. (Against which loss may be set off or relieved.)	£8,300	

As the net statutory income for 1927-28 was in excess of the amount of the loss on which relief was claimed, relief could be given on the whole of the loss.

The computation of the profits assessment for 1928-29 would be as follows :—

Year to 30th September 1927—

Loss	£6,000
Exclude amount on which relief granted for 1927-28	6,000
Assessable profit, 1928-29	Nil

Obviously there is no balance of unexhausted loss to be carried forward against future profits.

EXAMPLE II

Suppose the circumstances and figures quoted in the preceding example still obtain with the exception that for 1927-28 the company was entitled to an allowance for depreciation equal to £250.

The position would then be as follows :—

Loss for year to 30th September 1927 ..	£6,000
Add Depreciation allowance for 1927-28 ..	250
Total amount of loss on which relief may be claimed	£6,250

The aggregate statutory income for 1927-28 would be as follows :—

Case I Assessment	£8,000
Less Depreciation	250
	7,750

Schedule A net	£500	
		8,250
Less Charges		200
Net statutory income against which loss may be set-off		£8,050

As the statutory income for 1927-28 still exceeds the amount of the loss on which relief may be claimed (viz. £6,250 above), the whole loss may be given effect to in the relief.

NOTE.

The revised Case I liability for 1927-28 would, of course, be

Profits as assessed	£8,000	
Less Depreciation	250	
Net		7,750
Amount of loss available for relief		6,250
Revised net liability		£1,500

Repayment would be made of tax paid, in respect of Case I liability as originally assessed, exceeding the tax payable on the revised net liability.

If, at the date of making the claim for relief, the tax payable in the original profits assessment had *not* been paid, a discharge of tax would be made in order to reduce the original amount to the duty payable on the revised net liability.

The computation of the profits assessment for 1928-29 would then be as follows :—

Year to 30th September 1927—Loss	£6,000
Add back amount on which relief has been granted	6,250
Assessable Profit, 1928-29	£250

NOTE.

Where the amount of loss in respect of which relief has been given, exceeds the adjusted loss shown by the Accounts (by reason of Depreciation allowance having been added to the latter) the difference will enter into the computation of future assessments as a positive or profits figure—see year to 30th September 1927 in computation of 1928-29 assessment above. The profit of £250 for that year arises by reason of the £250 depreciation allowance which was added to the amount of adjusted loss per the Accounts, viz. £6,000.

EXAMPLE III

For the year 1927-28, X.'s total statutory income was £1,118, made up as follows :—

(*a*) Profits of business as manufacturer.		
Year to 31st December, 1926	£708	
Less Depreciation	20	
		£688
(*b*) Property assessed Schedule A net		150
(*c*) Taxed Dividends (gross)		300
		1,138
Less Ground Rent		20
		£1,118

Tax payable by X. for 1927-28 was £116 2s. 0d. made up as follows :—

				Tax
(*a*) Assessed profits as manufacturer			£708	
Less: Depreciation	£20			
E.I.R.	115			
P.A.	225			
Ch. (3)	90			
	—	450		
		£258		
Tax thereon—				
225 @ 2/-	£22 10 0			
33 @ 4/-	6 12 0			
	£29 2 0			
Less L.A. 20 @ 3/- ..	3 0 0			
			£26	2 0
(*b*) Property—assessed Schedule A.				
Net 150 @ 4/-			30	0 0
(*c*) Taxed Dividends gross £300, tax deducted			60	0 0
			£116	2 0

The accounts of the business for the year to 31st December 1927 showed a loss after adjustment for Income Tax purposes of £340, and a claim was lodged to have relief for 1927-28 in respect of the loss.

At the date of lodging the claim only the first instalment of tax payable under Schedule D, viz. £13 1s. 0d., and Schedule A, viz. £30 0s. 0d., had been paid.

The adjustments necessary on account of the relief claimed would be carried out as follows :—

Adjusted Loss for year to 31st December 1927	£340
Add : Depreciation allowance 1927-28 ..	20
Loss on which relief may be given	£360

Aggregate income for 1927-28 as above, £1,118.

∴ Whole of the loss of £360 may be relieved.

Relief will be given primarily from earned income and the Income Tax liability for 1927-28 will be recast as follows :—

				Tax
(*a*) Profits assessment			£708	
Less : Depreciation			20	
Net			£688	
Deduct : Loss on which relief may be granted			360	
Revised net			£328	
Less : E.I.R.	£55			
P.A.	225			
Ch. (part)	48			
	—		£328	Nil
(*b*) Property net Schedule A			150	
Deduct : Charges—				
(Covered by taxed dividends) ..			Nil	
			150	
Ch. (balance)			42	
			£108	

						Tax		
Tax thereon—								
108 @ 2/-			£10	16	0			
Less L.A. 20 @ 2/-			2	0	0			
			8	16	0			
Less R.R.R. (balance of £225) 225 — 108 = 117 @ 2/- ..			11	14	0			
Net tax overpaid						£2	18	0
(*c*) Taxed Dividends gross £300, tax deducted						60	0	0
Total due from X. for 1927-28 on revised statutory income						57	2	0
X. has already paid tax for 1927-28 as follows :								
(*a*) Schedule D—First instalment			£13	1	0			
(*b*) Schedule A—			30	0	0			
(*c*) Taxed Dividends—by deduction			60	0	0			
						103	1	0
Tax overpaid						£45	19	0

X. will, therefore, be entitled to—

(*a*) Have the sum of £45 19s. 0d. repaid, and

(*b*) Have the second instalment of Schedule D tax discharged.

The liability for 1928-29 would be calculated as follows :—

Year to 31st December1927—Loss ..	£340
Add back amount on which relief given	360
Assessable Profit, 1928-29	£20

NOTES.

(*a*) After allowing for the amount of the loss on which relief is to be given, the revised statutory income is under £1,000 and relief for Life Assurance premium will be granted at 2s. rate only.

(*b*) In the calculation of the tax payable on the revised liability for 1927-28 no repayment can be claimed in respect of tax suffered by deduction on the taxed dividends as the reduced rate of 2s. applicable to the first £225 of taxable income has been taken into account in arriving at the net tax overpaid on liabilities subject to direct assessment, viz. £2 18s.

The actual amount of relief to which X. is entitled may also be calculated in a much simpler way as follows :—

Total Loss on which relief may be claimed as before	£360

This will be set off primarily against earned income,

i.e. Profits assessment	£708
Less : Depreciation	20
Net	£688

assessed under Schedule D ;

but the following points are to be noted :—

(*a*) The earned income relief already given in the original assessment will be excessive to the extent of the E.I.R. on the £360, by which the amount of earned income is now reduced, i.e. by £60.

(*b*) As the amount of taxable income charged at the full standard rate for 1927-28 is more than the amount on which relief is to be given, the rate of tax at which relief is to be calculated will be 4s. in the £.

(*c*) As the revised statutory income of X. is under £1,000 the allowance for L.A. as already granted will be excessive and there will fall to be disallowed £20 at 1s. (viz. 3s. — 2s.).

Amount of relief calculated as follows :—

Loss as above			£360
Less: E.I.R. over allowed			60
			£300
	£	s	d
Relief due on 300 @ 4/– in the £	60	0	0
Deduct: relief over allowed for L.A. .. .. (20 @ 1s. in the £.)	1	0	0
	£59	0	0
Less: Tax unpaid :—			
Second Instalment Schedule D £13 1 0	13	1	0
For repayment	£45	19	0

EXAMPLE IV

A farmer owning and occupying his own lands makes a loss in the year of assessment, 1928-29, agreed for Income Tax purposes at £120.

He claims to have the Schedule B assessment for 1928-29 reduced to *nil* and also to have the amount of the loss set off against his other income for the year.

His income and assessments for the year 1928-29 were as follows :—

			Tax
Schedule A of Farm, assessed net ..	£180		
P.A. (part)	£17		
Ch.	60		
	—	77	
		£103	
Tax thereon : 103 @ 2/- ..	£10 6 0		
Less R.R. relief, 60 @ 2/- ..	6 0 0		
		£4 6 0	

Schedule B. of Farm assessed ..	£250		
E.I.R.	£42		
P.A. (part)	208		
	250		
			Nil
Dividends taxed (gross), £60, Tax deducted		12	0 0
Total Tax		£16	6 0

The Schedule B assessment is reducible to *nil* under the provisions of Rule 6 of Schedule B, whereby the Schedule B liability may be revised to the profits of the year of assessment if the amount of the latter is less than the Schedule B assessment. This means that the allowances granted in the original Schedule B assessment are cancelled, and may be claimed against the other income. Further, the amount of the loss is also available for relief out of other income subject to tax. Relief would be given as follows :—

Revised statutory income for 1928-29 :—	
Schedule B.	Nil
Schedule A net	£180
Taxed dividends gross	60
Revised aggregate income	£240

As the ascertained amount of the loss for 1928-29 is less than the aggregate income, relief on the whole of the loss may be granted as follows :—

Aggregate statutory income (after application of Rule 6, Schedule B)	£240
Deduct : Amount of loss available for relief ..	120
Net statutory income	£120

As the final net statutory income is £120 and the total personal, &c., allowances (viz. P.A. 225 + Ch. 60 = 285) to which the farmer is entitled for 1928-29 exceed this amount, the net result is that the farmer is exempt from Income Tax for 1928-29.

If the tax had been paid under Schedule A (there was no tax payable in the original Schedule B assessment) at the date of making the claim, he would be entitled to have the whole of it repaid, and to be repaid in addition the tax borne by deduction at the source on his taxed dividends.

If, on the other hand, the tax due under the original Schedule A assessment was unpaid, he would be entitled to be repaid the whole of the tax deducted from his taxed dividends, and to have the Schedule A tax discharged.

It should be noted that, in the case of farmers, for loss claims as for any other claims dependent upon the actual results of the year of assessment, it is usual to adopt the year to Whitsunday, May Day, or any other Spring term day to which the accounts are made up, as coinciding with the year of assessment ended on the preceding 5th April.

Rule 13 of Cases I and II

It has already been pointed out at the beginning of the present chapter that, where the figure for assessment purposes under Cases I and II of Schedule D is a negative quantity, the income is treated as *nil* for Income Tax purposes and does not operate to reduce the amounts of other income. There is, however, an exception to this general principle, covered by the provisions of Rule 13 of Cases I and II. The effect of this rule is that where a person carries on, either solely or in partnership, two or more *distinct* trades, the profits of which are chargeable under the rules of Schedule D, he may

deduct from, or set off against, the profits as computed on the legal basis in respect of one or more of such trades, the loss so computed, sustained in any other such trade. Separate statements may be made as to each trade. Suppose, for instance, that A. is sole proprietor of two separate businesses, one a manufacturing business and the other a retail business, in respect of which separate accounts are rendered and which are also separately assessed. For the year of assessment 1928-29 the former business shows a profit, for assessment purposes, of £800, and the latter a loss of £200. It is permissible for A. to claim to have the liability in respect of the manufacturing business, viz. £800, reduced by the amount of the loss on the retail business, viz. £200, and to be assessed on the difference, viz. £600. This relief also may be claimed where one or other business is owned by the taxpayer's wife.

It should be noted that where a loss is set off, as above, against an assessable profit, an adjustment requires to be made in computing future assessments.

It should also be noted that a loss in a trade, &c. (Cases I and II, Schedule D), carried on by a taxpayer cannot be set off against liability assessed under any other schedule or any other case of Schedule D.

A claim under this rule should be made at the beginning of the year of assessment, before the actual assessments have been made, unless in the case of a new business where the amount of the liability cannot be ascertained before the end of the year of assessment. In this case the claim should be made as soon as possible after the figures of liability have been ascertained.

Errors in Assessment.—If it is discovered that for any year an error has been made in computing the amount of the liability under Schedule D, or according to the Rules applicable to Schedule D, a claim may be made by the taxpayer to have the assessment revised to the correct

amount. It should be understood that the application of this relief does not extend to give the taxpayer an opportunity of making an appeal against the amount of his assessment for any year outside the usual time limit within which appeals may be lodged. The relief is confined to cases where it is discovered that the original assessed liability is incorrect because of some *bona fide* error in the computation of the liability. Such an error might arise from the omission to include some legitimate expenditure or from an oversight in the matter of recording total income or from an ordinary clerical error in calculation. A claim of this kind must be made—

(*a*) As regards assessments made not later than 5th April 1923 within three years after the end of the year of claim.

(*b*) As regards assessments made after 5th April 1923, within six years after the end of the year of claim.

Section 45 (8) (Finance Act, 1927) extends this relief from the year 1928-29 inclusive to errors in assessments under Schedule E.

Husband and Wife Claiming Separate Assessment.—For Income Tax purposes the income of a wife is considered to form part of her husband's income. The husband remains responsible for any liability which arises on his wife's income. It is, however, provided in the Income Tax Act that a claim for separate assessment may be made by the husband and the wife. The application must be made by the husband or the wife within six months before the 6th day of July in any year of assessment for which the application is made and for that year the liabilities of the husband and wife are dealt with independently. Any direct assessments requiring to be made on the wife's income are raised on the wife in her own name. In the case of persons marrying during the year of assessment, an application for separate assessment as regards that year

may be made at any time before the 6th July in the following year.

Table of Time Limits for Claims

Nature of Claim	Reference to Income Tax Act	Time Limit
1. (*a*) Cases I and II, Schedule D. Businesses commenced within the year preceding the year of assessment.	Section 29 (1) (*a*), Finance Act, 1926.	12 months after the end of the year of assessment.
(*b*) Cases IV and V, Schedule D. (1) Income arising on 6th April in the year preceding the year of assessment; or (2) On some day in the year next before the year preceding the year of assessment.	Section 29 (1) (*b*), Finance Act, 1926.	12 months after the end of the year of assessment.
(*c*) Case III, Schedule D. (1) and (2) as for (1) and (2) (*b*) above.	Section 17, Finance Act, 1922.	12 months after the end of the year of assessment.
(*d*) Schedule E. (1) and (2) as for (1) and (2) (*b*) above. Claims to have the actual income of the year of assessment substituted for the assessed income.	Section 45 (4) Finance Act, 1927.	12 months after the end of the year of assessment.
2. Succession, Cases I and II, Schedule D. Claim to have business &c., treated as discontinued and recommenced.	Section 32, Finance Act, 1926.	Within 3 months after the date of change.
3. Error in assessment. Schedule D—any case.	Section 24, Finance Act, 1923. Section 27, Finance Act, 1926.	(*a*) For assessments made before 6th April 1923 within 3 years after the end of the year of claim. (*b*) For assessments made after 5th April 1923 within 6 years after the end of the year of claim.
4. Error in assessment. Schedule E. First year.	Section 45 (8) Finance Act, 1927.	Within 6 years after the end of the year of claim. First year of claim 1928-29

Table of Time Limits for Claims—Contd.

Nature of Claim	Reference to Income Tax Act	Time Limit
5. Set-off of losses. Cases I and II, Schedule D.	Rule 13, Cases I and II, Schedule D.	At any time before the assessment is signed by the Commissioners.
6. Loss in trade, &c. (*a*) Cases I and II, Schedule D. (*b*) Lands for husbandry only. Schedule B. (*c*) Woodlands assessed under Schedule D.	Section 34, Income Tax Act, 1918.	Within 12 months after the end of the year of assessment.
7. Schedule E—application for assessment on actual income for 1927-28 and 1928-29	Section 45 (3) Finance Act, 1927.	Not later than 30th June 1929.
8. Set-off of losses. Claim by previous proprietor or partner of a business transferred to a company to set-off losses incurred prior to transfer against income derived from the company.	Section 29 (1) Finance Act, 1927.	Within 12 months of the end of the year of assessment for which the claim is made.
9. Farming—Schedule B. Application for assessment under Schedule D.	Rule 5 of Rules applicable to Schedule B.	Within 2 months after the commencement of the year of assessment for which the claim is made. (In Scotland before 5th August in the year of assessment.)
10. Profits falling short of Schedule B assessment on lands occupied for husbandry only.	Rule 6, Schedule B.	Within 12 months after the end of the year of assessment.
11. Separate assessments —husband and wife.	Rule 17 of General Rules applicable to all Schedules. Section 26, Finance Act, 1919	Not later than 5th July in the year for which the claim is made, or where the claim relates to the year of marriage, not later than 5th July following that year.
12. Claim for repayment in respect of personal allowances and reliefs.	Section 30 Finance Act, 1923.	Within 6 years after the end of the year of claim.
13. Application for relief by non-resident British subjects.	Section 24, Finance Act, 1920. Section 19, Finance Act, 1925. Section 20, Finance Act, 1926.	Within 3 months of the decision by the Special Commissioners or the Commissioners of Inland Revenue.
14. Application for relief as a new business by succession during 1927-28.	Section 32, Finance Act, 1926.	Not later than 5th October 1929.

Separate statements of income may be called for from both husband and wife, and it should be noted that, in addition to this, a statement of the total combined incomes of husband and wife may be called for from either the husband or the wife.

The granting of separate assessment to husband and wife affords no relief beyond an apportionment of the total tax, which would have been payable on the combined incomes, in proportion to the incomes of the husband and wife respectively. For this purpose, earned income relief is granted separately in the assessments on earned income of the husband and wife (subject to the ordinary maximum of £250—each does not receive £250), personal and family allowances are granted to each in proportion to their respective *assessable* incomes, and Life Assurance to the spouse by whom the premiums are paid.

CHAPTER XV

DEPRECIATION REPAIRS AND RENEWALS & OBSOLESCENCE

It has already been pointed out, in the course of a previous chapter, that it is a common commercial practice, in businesses where the assets are liable to exhaustion, to write down these assets year by year, by an amount which, in the case of each asset, will be sufficient, if continued over a period estimated to be the " life " of the asset, to cover the whole of the original cost. Where this procedure is adopted, the result is, that at the end of a certain number of years, when it is considered that the particular asset will no longer be useful for the purposes for which it was acquired, the capital value of the asset in the trader's books will have been reduced to *nil* or to a nominal value which represents its " scrap " value. This commercial practice is adopted generally in connection with all kinds of assets, the value of which is liable to depreciation or exhaustion over a period of years and will be applied as a rule to land, buildings, plant and machinery, leases, goodwill, patents, &c. &c.

For Income Tax purposes, such amounts as have been

charged against profits in order to reduce the values of any of the business assets, are considered to be inadmissible charges and must, therefore, be written back in computing the adjusted profits for Income Tax.

There is, however, one particular kind of asset which, in addition to being used *in* the business, may be regarded as being actively concerned in the actual productive processes of the business, and thereby transferring part of its own value, to the value of the tangible productions from which the profits arise. The asset referred to is Plant and Machinery, and Rule 6 of the Rules applicable to Cases I and II of Schedule D formulates the conditions under which an allowance may be made with regard to such Plant and Machinery.

In the first place it should be noted that the allowance is to be made in *charging* the profits or gains. It follows, therefore, from the wording, that the allowance is to be made from the ascertained figure of profits representing the *assessable liability*.

Prior to 1925-26 the allowance was confined to the case of a trade assessable under Schedule D. By the 1925 Finance Act, however, the allowance was extended to cover all profits or gains, whether assessable under Schedule D or otherwise, of a profession, employment, vocation or office.

The allowance is to represent the diminished value by reason of wear and tear, during the year of assessment, of any machinery or plant used for the purposes of the trade and belonging to the person by whom it is carried on. Where the Plant and Machinery is let to the person by whom the trade is carried on, on terms expressing that he is bound to maintain it and deliver it over in good condition at the end of the lease, the person to whom it is let

is deemed to be the " owner " for the purposes of the wear and tear allowance. In these circumstances no allowance falls to be made to the lessor of the Plant and Machinery. Where, on the other hand, the lessor of the machinery undertakes to keep it in good condition, he will be entitled to claim an allowance for Wear and Tear.

If the rent for the use of the Plant and Machinery is paid to the lessor without deduction for Income Tax, an assessment will be raised on him for the rent so received and the allowance for Wear and Tear may be claimed against such assessment. Where, however, the lessee deducts Income Tax from the rent at the time of payment, the lessor will be entitled to claim allowance for Wear and Tear and to be repaid tax, on the appropriate amount of the allowance, out of the tax deducted from the rent.

The allowance, which is confined to the subjects designated by the term " *Plant and Machinery* " is to cover the *diminished value by reason of Wear and Tear.*

In practice the term Plant and Machinery includes not only machinery but boilers, engines, shafting, fixtures, fittings and, generally speaking, all assets which are liable to wastage in the uses to which they are put in connection with the trades. In strictness, implements, utensils, loose tools, and office furniture are not considered to come within the category of plant and machinery, and allowance is made for these by allowing against the trading profits such sums as are expended in supply, maintenance, repairs, or alterations. That is to say, that against the profits of each period for which accounts are rendered, there may be charged the amounts actually expended in the period by way of upkeep, supply, repair or alterations of implements, and utensils. As a matter of practice, however, the Inland Revenue authorities do not object to

the treatment of these subjects on a depreciation basis, i.e. by an over-all yearly allowance (usually 5 per cent.) on the written-down value. Where this concession is granted, renewals, of course, are required to be charged to capital. Ships, Tramways, &c., by means of which profit-making undertakings are carried on, would come within the scope of Plant and Machinery.

The allowance is limited to the diminution in value by reason of Wear and Tear. It may often happen that various factors and contingencies operate to reduce the value of the Plant and Machinery, beyond the diminution of value directly brought about by Wear and Tear, but it is only in respect of the actual *physical deterioration* of the plant, &c., that an allowance may be made.

The actual amount of the allowance for Wear and Tear is in the jurisdiction of the Commissioners by whom the assessments are made (i.e. the Additional or Special Commissioners, subject, of course, to an appeal on the question of the amount to the appropriate Commissioners, General or Special), and the Act itself prescribes no figures, defining the allowance to be "such deduction as the Commissioners . . . may consider just and reasonable." It is, however, further stated that the aggregate amount of the deductions to be made for Wear and Tear must not exceed the total cost to the claimant of the Plant and Machinery on which the allowance is claimed, there being included in this cost the value of any improvements, alterations, or other capital expenditure upon the Plant and Machinery since its purchase.

In order to comply with the latter provision relative to the aggregate amount of the allowance to be given, and at the same time to obviate the necessity of keeping trace of every separate subject or item on which depreciation allowance is granted, the actual allowance is calculated for each year

of assessment upon the written-down value of the Plant and Machinery at the beginning of the year of assessment, which in actual practice is taken to be the written-down value of the Plant and Machinery at the date of the last Balance Sheet before the year of assessment. This method of calculating the allowance on the written down value is adopted in the case of all subjects except ships. The latter are usually regarded as having a definite "life," and the allowance in this case is usually calculated on the basis of a percentage allowance (based in turn upon the estimated number of years of the ship's "life") on the *prime cost*. At the end of its life a ship is usually considered to have a scrap or break-up value, and this is usually assumed to be a fractional part of the total or prime cost corresponding to the ratio of one year to the total number of years of the ship's life. If, for example, a ship cost £25,000, and was estimated to last 25 years, the break-up value would normally be reckoned as one twenty-fifth of £25,000 or £1,000, and an allowance of 4 per cent. (one twenty-fifth) or £1,000 would be made each year. Although in theory the amount of depreciation allowance is at the discretion of the Commissioners concerned, as a matter of *practice*, the amount for any year of assessment is usually agreed with the Inspector of Taxes on the occasion of his computing the Income Tax liability for the same year. The taxpayer, of course, has the right of appeal against the amount proposed to be allowed.

The actual amount of the allowance is usually arrived at as a percentage of the capital cost of the Plant and Machinery used in the trade. This percentage varies with the particular type of the machinery, and in many cases trade associations have agreed with the Inland Revenue Department certain percentages appropriate to certain trades, these being carried out on the *written down value* principle, e.g.

	Per cent. on W.D.V.
Commercial Motor Vehicles—	
Propelled by steam power	15
Propelled by power derived from internal combustion engines, i.e. motor lorries and vans	20
Steel Manufacturing—Machinery and Plant used in productive processes	5
&c. &c.	

Information as to rates on the various types of Plant and Machinery for different trades, &c., may be obtained at the office of the Inspector of Taxes.

An allowance for depreciation is usually computed as follows :—

X. commenced business 1st January 1926 and purchased Plant and Machinery which cost £8,000. The rate of depreciation agreed with the Inspector for the particular type of Plant and Machinery is 5 per cent.

The allowance for 1925-26 (three months' liability only) would be :—

Cost as at 1st January 1926	£8,000
Allowance for 15 months @ 5 per cent. ..	500
Written down value	£7,500

The allowance for fifteen months is to cover the Income Tax years 1925-26 and 1926-27, and is allocated £100 to the former year and £400 to the latter.

For 1927-28 the allowance would be £375, being 5 per cent. on the above £7,500, leaving a value to be carried forward of £7,125.

If additional plant was added during the year to 31st December 1927, costing, say, £500 (chargeable, of course, against capital), the allowance for 1928-29 would be :—

Written down value carried forward from 1926-27	£7,125
Additions in year to 31st December 1927 ..	500
	£7,625
Allowance for 1928-29 @ 5 per cent.	381
Written down value to be carried forward ..	£7,244

If in the year to 31st December 1928, new plant is installed costing £200, and part of the old plant was sold for £50, the allowance for 1929-30 would be :—

Written down value brought forward from 1927-28	£7,244
Add: Additions for year to 31st December 1928	200
	£7,444
Deduct: Sales for year to 31st December 1928	50
	£7,394
Allowance for 1929-30 @ 5 per cent.	370
Written down value to be carried forward ..	£7,024

The allowance is made to represent the diminution in value by reason of Wear and Tear during the year of assessment. In practice, however, as the allowance for any year of assessment is based on the written down value brought forward from the previous year of assessment, with adjustments for additions or sales during the financial year ended prior to the year of assessment, it is customary to ignore any additions to, or sales of, Plant and Machinery made during the year of assessment.

It may happen that the depreciation allowance for a year of assessment exceeds the amount of the actual assessed liability, or that the allowance cannot be given effect to by reason of there being a "loss" for the year of assessment. In these cases the whole of the depreciation, or such part of it as cannot be allowed, may be carried forward from one year to another and added to the allowances for subsequent years till the total allowances due have been given effect to.

Further, if the gross assessment for 1927-28 on A. was £500, subject to a depreciation allowance for that year of £400, and for the same year A. paid charges, not covered by other income, to the extent of £200, then in order to keep the charges covered, the depreciation allowance would require to be restricted to £300, leaving a balance of £100 to be carried forward to 1928-29, thus :—

Liability, 1927-28	£500	
Less: Depreciation allowance (part)	300	
Net chargeable	£200	(to cover charges)

Leaving £100 of Depreciation to be carried forward.

The claim for depreciation allowance must be made annually on the Form requiring a Statement of Total Income of the trade.

It should be clearly understood that where an application is made by the taxpayer for an annual allowance in respect of depreciation, such an allowance, where granted, is considered to be *in lieu of* an allowance as an ordinary trade expense in the year in which it is incurred, for the cost of renewal of the Plant and Machinery. Where an annual depreciation allowance has been granted in respect of

Plant and Machinery, the actual cost of *renewing* the particular subjects on which the allowance has been granted will not be admitted as a charge against the profits, but must be regarded as capital expenditure. On the other hand, where the taxpayer has not claimed an annual allowance for depreciation, he will be allowed to charge as an ordinary business expense the *actual cost* of renewing the Plant and Machinery or other subject which might have been liable to a depreciation allowance.

In this connection it should be noted that the amount which will be admitted as the cost of renewals will be restricted to the net cost of replacement of an article *similar in all respects* to the one replaced, *diminished by* the sum realised on the sale of the asset replaced. The cost of replacement is the cost of the *new* subject, *not* the cost of the old one replaced.

If the article replacing the one discarded is of a superior type, a disallowance will be made of part of the cost of the replacing article to represent the value of the *improvement* in the latter compared with the original which it has replaced.

Although the cost of renewals of Plant and Machinery will not be admitted as a business expense where an annual depreciation allowance has been granted on the Plant and Machinery, cost of renewal is not considered to cover the cost of renewing parts of machinery which become worn out and require to be replaced, so long as the replacements are not of such a nature nor so extensive as to destroy the identity of the subject on which depreciation allowance has been granted.

Further, the cost of ordinary repairs and upkeep of Plant and Machinery is admitted as ordinary business expenditure as it arises, and is independent of the treatment of

depreciation and renewals. Where, however, the expenditure under the heading of repairs includes any outlay on additions, improvements, or alterations of the Plant and Machinery, such outlay will fall to be disallowed as capital expenditure, but may be added to the value of Plant and Machinery for depreciation purposes.

It was pointed out that the aggregate allowance for depreciation must not exceed the cost of the Plant and Machinery in respect of which the allowance is claimed; this means, of course, the cost to the person claiming the allowance. Thus, in the case of a business changing hands where Plant and Machinery are transferred with the business, the written-down value of the Plant and Machinery at the date of sale may have been, say, £2,000; if, however, the Plant, &c., was acquired by the successor at an actual cost of, say, £8,000, the latter would represent the figure on which depreciation allowance to the successor would be calculated.

Before leaving the subject of depreciation it may be pointed out that it is provided that an *application* may be made to the *Commissioners of Inland Revenue* for an alteration of the amount of any allowance for Wear and Tear. These Commissioners, unless they have reason to think that the application is "frivolous or vexatious," are required to refer the application to a Board of Referees, and the latter, provided that they are satisfied that the application is made by or on behalf of a considerable number of persons engaged in any class of trade or business, may consider the application and determine the amount of the allowance. The appointment of the Board of Referees is in the hands of the Treasury.

There now remains to be considered the allowance that may be claimed in respect of obsolescence of Plant and Machinery. The provisions governing this allowance are contained in Rule 7 of the Rules of Cases I and II, Schedule D. The substance of the provision is to allow as an

expense of the trading year in which it is incurred, the cost of replacing any plant or machinery which has become obsolete. The cost to be allowed is the original cost diminished by the total of the sums which had been given by way of Wear and Tear allowances on the Plant and Machinery replaced, to the date of replacement, and also by the amount, if any, realised by the sale of the Plant and Machinery. In the ordinary way, of course, in computing depreciation allowances, the value of the plant, &c., replaced as obsolete will be excluded from the written-down value of Plant and Machinery operating for future depreciation allowance, and the cost of the new plant superseding the obsolete plant discarded will be treated as additions to the value of plant.

The following example will illustrate how the allowance operates :—

The written-down value of the Plant and Machinery of the A. B. C. Co., Ltd., at 31st December 1926 was £15,000, and the latter figure included a machine which was purchased new in 1924 for £3,000, but which was discarded in 1927 as obsolete and replaced by an improved type of machine which cost £5,000 ; £50 was received on the sale of the obsolete machine. The rate of depreciation which had been allowed on the whole of the company's Plant *and* Machinery from 1924-25 inclusive was 5 per cent.

Original cost of obsolete machine, purchased 1924		£3,000
Depreciation allowance granted thereon :—		
1925-26, £3,000 @ 5 per cent... .. w.d.v. forward £2,850.	£150	
1926-27, £2,850 @ 5 per cent... .. w.d.v. forward, £2,708.	142	
1927-28, £2,708 @ 5 per cent... .. ∴ w.d.v. £2,572, sold 1927.	136	
	£428	

∴ Amount to be allowed as a *deduction from the profits of the year* 1927—

Cost of plant replaced (less total Wear and Tear Allowance + sum realised on sale)

= £3,000 — (428 + 50)

= 3,000 — 478

= 2,522

The Wear and Tear allowance for 1928-29 would be calculated as follows :—

Written down value brought forward from 1927-28		£15,000
Deduct: w.d.v. of obsolete plant discarded	..	2,572
		£12,428
Add: cost of new Plant in 1927		5,000
		£17,428
1928-29 allowance @ 5 per cent.		872
w.d.v. to be carried forward		£16,556

Although the wording of the section covering obsolescence allowance is quite clear, much discussion and controversy has arisen in recent years on the subject of what exactly is covered by the term "obsolete." The usual acceptation of the term is " out-of-date " or " old-fashioned," but some standard dictionaries also define the term as " worn-out." Consequently, there has been an attempt to establish a title to the allowance in cases where an item of Plant and Machinery, which has been subject to annual Wear and Tear allowances, has been replaced before the total allowances granted for depreciation are equal to the original cost of the subject replaced, less the sum realised

by its sale. In other words, it is sought to obtain as obsolescence allowance, the difference between the cost of any article replaced, and its written-down value for depreciation purposes plus the sum realised by the sale of the article. While it is admitted that Income Tax practice in this matter is not consistent as between different Districts, it has also to be admitted that Income Tax practice is tending to recognise this claim. The section was obviously intended to cover the case where specific plant purchased for some definite process was superseded, before it was really worn out, by an improved type of machinery which rendered the former unsuitable for the purposes for which it was originally acquired, thereby causing the owner to replace it by the newer type in order to effect economies or other advantages in production. Normally, plant is rendered obsolete through circumstances outside the control of the owner of the plant. Strictly speaking, the term means " out-of-date," and machinery, like anything else, may become " out-of-date," independent of its age, by the introduction of new and improved types. Accordingly, therefore, it does not appear to be quite within the meaning of the section to interpret obsolete as "worn-out," though one or two recent tax-cases appear to introduce this phrase in connection with obsolescence claims.

The question naturally arises, therefore, as to whether it is preferable—on the understanding that the taxpayer is free to exercise his choice as to whether he will claim an annual allowance for wear and tear or the cost of renewals as and when they occur—to deal with Plant and Machinery (which includes motor cars, a very common type of subject) by way of depreciation allowance or renewals.

Although the system of an annual allowance for depreciation has the advantage of relieving a certain amount each year from tax, it would appear that the safer method so far as the taxpayer is concerned, to ensure that there will be

no loss on the actual cost of renewal, would be to claim the cost of renewals in preference to the annual allowance for depreciation. This method is particularly advisable in the case of motor cars where it may be advantageous, even from a commercial point of view, to replace them at intervals of a few years.

CHAPTER XVI

ANNUAL CHARGES

(Including Royalties)

It often happens that there fall to be paid, either out of income which is liable to assessment to Income Tax, or from income which is not chargeable to Income Tax (e.g. rates levied by a Local Authority, income of a charity or other body specifically exempted by statute from Income Tax), certain payments due to a person other than the owner of the income, in virtue of a deed, contract, or other authority.

Provisions regarding the manner in which such payments are to be treated for Income Tax are contained in various sections of the Income Tax Act. The most important of these sections are : Rule 4 of No. 8 of Schedule A (covering " annual sums " payable out of income assessable under Schedule A), Rules 19 and 21 of the General Rules applicable to all schedules, and Section 209 of the Income Tax Act, 1918.

The Income Tax term " charges "—details of which are called for in connection with every statement of total income for Income Tax purposes, in a section provided in the form supplied—covers all " *annual sums* " which the taxpayer is liable to pay under a legal obligation, and from

which, in Income Tax law, he is authorised to deduct tax at the time of payment, and other payments, made by him from his income, from which he may not be entitled to deduct tax. All " charges " are deducted from the gross amount of income in order to arrive at the total net statutory income which determines a taxpayer's reliefs and allowances (where these are dependent on total income, e.g. rate of life assurance relief, age relief, marginal life assurance or age relief), and his liability to Super Tax.

In the case of " charges " from which the tax is deductible at the time of payment, and which are paid out of income assessable to Income Tax, no allowance is made in computing the tax payable on taxable income, the amount of these charges being kept in charge at the full standard rate of tax in order to recover from the payer the amount of the Income Tax which he has power to deduct on making the payments to the person or persons entitled thereto. In these cases the person making the payments simply acts as collector of the Income Tax on behalf of the Revenue, and must, therefore, account to the Revenue Authorities for the amount of tax deducted by him.

(This is part of the general system of *taxation at the source*, which is adopted by the Revenue Authorities wherever possible and legalised by statute, and serves the double purpose of reducing the actual number of direct assessments to be made, and minimising the chances of evasion on the part of taxpayers.)

Where the " charges " are paid out of income upon which there is no Income Tax liability, the payer must still exercise his right to deduct tax from the payment, and the tax so deducted becomes a debt due by him to the Crown and must be handed over by him to the proper authorities. The Finance Act, 1927 (Section 26), has amended Rule 21 (which refers to the tax deducted from payments made out of profits or gains not wholly brought into charge to

tax) to require the payer of such payments to render an account of the payments and the tax deducted to the Commissioners of Inland Revenue for the use of the Special Commissioners who are to assess and charge the payments (or the part of the payments not covered by profits or gains charged to tax) in order to recover the tax.

The existing provisions regarding assessment, appeals, collection, &c., of tax, apply with regard to such assessments.

The expression "annual payments" does not refer exclusively to payments made once a year, but covers payments made at longer or shorter intervals where the amounts are calculated with reference to a fixed period and which are paid or intended to be paid year after year. Dividends paid by a limited company come within a further provision and tax is deducted from the dividends at the time of payment; thus the company, which has borne tax on the whole of its profits, recoups itself on the amount of the tax paid in respect of the profits paid away as dividends.

For years to 1927-28 inclusive where the annual payments were made out of profits or gains brought into charge to tax (that is to say, where the payments were made by a person from income liable to tax either by direct assessment of the income or by deduction of tax at the source from the income) Income Tax was to be deducted from the gross amount of the payment due, at the standard rate or rates in force over the period in which the income, out of which the payment was made, was accruing due.

Thus, in the case of a limited company paying a dividend for its financial year to 31st December 1923, the rate of tax to be deducted from the gross amount of the dividend was 4s. 7½d. in the £, being three months at 5s. in the £ (rate of tax for 1922-23) in respect of profits accrued from 1st January 1923 to 5th April 1923, and nine months at

4s. 6d. in the £ (rate of tax for 1923-24) in respect of profits accrued from 5th April 1923 to 31st December 1923.

By Section 39, Finance Act, 1927, a simplification taking effect from 1928-29 inclusive regarding deduction of tax from annual payments is effected. The "accruing rate" of deduction of tax (i.e., a rate corresponding with the rate or rates in force over the period during which the payment was accruing due) is, with two exceptions, abolished and the deduction will now be made at the standard rate for the year in which the amount payable became due. (The exceptions refer to deductions of income-tax on payment of rent by a tenant and of certain annual charges, e.g. feu-duty, &c., payable in Scotland on 15th May.) Any income so received under deduction of tax at the standard rate in force for any year is to be regarded for income-tax purposes as income of that year and similarly any payments made under such deduction of tax are to be allowed as deductions for that year

On the other hand, where the annual payments are made out of profits or gains not brought into charge to tax, Income Tax is to be deducted from the gross amount of the payment, at the rate in force *at the date of payment.*

As has already been indicated, where annual payments are made from income subject to direct assessment, the tax deducted from the payments is recovered by the Revenue Authorities in the direct assessment on the income ; where allowances and reliefs are due in the ordinary way from the gross amount of the assessment on the income, these will be restricted, if necessary, in order to leave an amount taxable at the standard rate sufficient to realise the actual amount of tax deducted from the payments and due to the Revenue. As long as the annual payments have been made out of profits or gains brought into charge to tax, no further assessment can be made on the payer to recover the tax deducted from the payments. The decision in a

recent Income Tax case (*Attorney-General v. Metropolitan Water Board*) has had the effect of clearing up a position that was not a little obscure, and incidentally of strengthening the Revenue's claim for the tax deductible from the charges for any particular year of assessment.

Until recently it was the practice of the Revenue not to insist on collecting tax on charges payable for any year of assessment where the amount of income liable to assessment for that year was either *nil* (e.g. because of a loss) or less than the amount of the charges *and* the income of *the year of assessment* was sufficient to cover the gross amount of the charges.

The presumption was that although the charges were paid and tax deducted and retained by the payer in a particular year of assessment for which no tax was payable by the person liable to pay the charges, or less tax was payable than the amount of tax deducted from the charges, the income earned in the year of assessment would bear tax in the next year of assessment and thus restore to the Revenue the Income Tax retained by the payer of the charges in a period prior to the period of recovery by the Revenue.

Now, however, as a result of the decision in the case referred to above, annual charges of any year of assessment are to be regarded as primarily payable out of the taxed income of that year of assessment. Taxed income in this sense will, of course, include any assessments on profits or income chargeable by direct assessment, as well as any income which has suffered deduction of tax at the source—in other words, income on which tax will be borne for that year either by assessment or deduction. In those cases where the gross amount of the annual charges exceeds the taxed income of the year, an assessment will be raised under Rule 21 on the excess. In other words, tax will require to be accounted for on each

year's charges by one or both of the following methods where the payer of the charges has not sufficient income taxed by deduction to cover the charges :—

(*a*) Retention in liabilities directly assessed ;

(*b*) A direct assessment under Rule 21.

It may arise, of course, that all or part of the charges of any year of assessment are paid out of taxed income of previous years. Where such a claim is made and proved, any liability under Rule 21 would be restricted accordingly. The following example will illustrate the position :—

The A.B.C Co. Ltd. paid gross charges for the year 1927-28 amounting to	£500
The Case I liability for 1927-28 was	nil
The Company was assessed for that year on property owned and occupied, net annual value	£150
For the year 1927-28 the Company received income from investments, amounting to (gross) ..	£100
It was shown that £100 of the total £500 had been paid out of the taxed balance of Profit and Loss Account—being the unappropriated surplus of previous years' profits.	

The liability of the company to account for tax on charges by assessment under Rule 21 for 1927-28 would be restricted to £150, as follows :—

Total charges 1927-28		£500
Available for payment of charges :—		
(*a*) Taxed income 1927-28 :		
Case I	nil	
Schedule A property	£150	
Dividends	100	
(*b*) Taxed income of previous years ..	100	
	——	350
Liability under Rule 21		£150

Similarly, in dealing with claims under Section 34, Income Tax Act, 1918, the amount of income available for relief under this section will be arrived at after taking account of the total gross charges of the year, and will be limited to the amount of the excess of taxed income of the year over the annual charges of the year.

The recipient of the "annual charges" must allow the payer to deduct Income Tax therefrom, and any agreement requiring these to be paid in full is null and void.

All charges, in the nature of annual payments from which the payer is under legal obligation to deduct tax at the time of payment, are known as "retainable charges" (because tax to cover is retained in the payer's assessments) and include the following :—

Ground Rents, Chief Rents, Ground Annuals and Feu Duties.

Mortgage, Bond, and other *annual* interest.

Annuities or other annual payments, e.g. payable under a will, deed, &c.

Tithe Rentcharge where it is not assessed directly on the Tithe owner.

Patent Royalties.

There is, however, a further type of "annual charge" which, while it reduces the payer's gross income for Income Tax purposes, is not a *retainable* charge in so far as he is not required to account for tax at the standard rate on the amount of the payment ; the computation of tax due from him on his taxable income is made *exclusive* of tax on the gross amount of such charges. This position arises because of the fact that the payer does *not* deduct tax from such payments, or charges, and consequently is not required to account for tax thereon. The tax due on the amount of the payment is accounted for by the recipient, in whose hands the payment becomes income liable to assessment in

the ordinary way, and thus the payer is entitled to relief from tax on a corresponding amount. In some cases the arrangements to make the annual payments in full are a result of concessions by the Inland Revenue Authorities or agreement between the latter and the persons or bodies of persons entitled to the payments.

Examples of "charges," payment of which is made in full, include the following :—

(*a*) Interest payable to a Bank in the United Kingdom whether *annual interest* or *not.*

(*b*) Interest, *other than annual interest*, payable to a member of a Stock Exchange or to a discount house in the United Kingdom.

(*c*) Interest payable to a Building Society which is under arrangement "B" with the Board of Inland Revenue.

(*d*) Interest paid to certain Friendly and Co-operative Societies.

Where retainable charges are paid by a person having no taxable income (i.e. where the allowances, &c., due to the person are greater than the income liable to assessment, &c.) to another person having no taxable income, arrangement may be authorised for the charges to be paid in full ; this obviates the necessity for a repayment claim by the recipient of the charges to recover the tax deductible from the charges.

Where an individual pays retainable charges, and has taxed income from investments, &c. (i.e. income taxed at the source) to cover all or part of the charges so paid, the amount of such charges should be retained at the standard rate of tax in direct assessments on the payer, *only to the extent to which they are not covered* by the payer's own taxed income, and should be retained in charge

primarily in direct assessments on income *other than* earned income. The reason for this is obvious, because charges, in so far as they are retained in assessments on *earned income*, reduce the amount on which earned income relief may be granted.

Where charges are *payable by a partnership*, they must be covered in the *firm's* assessment in so far as they are not covered by investment and other income of the firm; they cannot be treated as covered to any extent by the private investment income of any of the partners.

The following example will illustrate how retainable charges are dealt with.

A.'s return of Total Income for 1928-29 was as follows:

(*a*) Solicitor		£800
(*b*) Property-owned, Net Annual Value		40
(*c*) War Loan Interest		10
(*d*) Taxed Dividends (gross)		15
		£865
Less: Charges—		
Ground Rent	£5	
Mortgage Interest (gross)	40	
Loan Interest (gross)	30	
	—	75
Net Statutory Income		£790

A was entitled to the following allowances:—

	E.I.R.
P.A.	£225
D.R.	£25
R.R. on	£225

The total charges, viz. £75, would be treated as covered to the extent of £15, the amount of A.'s investment income from which tax has been deducted at the source.

The assessment on the property and on the War Loan interest would both be charged at the standard rate and would cover a further £50 of the charges (viz. £40 + £10). This would leave a balance of charges, £10 [viz. £75 − (15 + 40 + 10)] to be covered in the assessment as solicitor, which would be carried out as follows :—

Gross Assessment			£800
Deduct : Excess charges			10
			£790
Less : E.I.R.	£132		
P.A.	225		
D.R.	25		
			382
			£408
Tax thereon—			
£225 @ 2/-	£22 10 0		
183 @ 4/-	36 12 0		
Add : Charges—			
£10 @ 4/-	2 0 0		
Total Tax Payable	£61 2 0		

It may happen that the terms of a deed or will provide for an annuity to be paid "free of tax." In this case the amount of the annuity to be kept in charge (and to be considered as taxed income in the hands of the recipient) is such an amount as, after deduction of tax at the standard rate, will leave an amount equivalent to the actual money payment made. This gross amount is calculated in precisely the same way as the gross amount of a tax-free dividend—see Chapter III.

Where a will or deed contains no specific instructions as to the deduction of tax, it is to be understood that the right to deduct tax exists.

As the result of a Court case (*Dayrell-Steyning v. Dayrell-Steyning*) the amount of alimony payable by a husband to his wife under an order of the Divorce Court in *England and Wales* made after 29th July 1922 is generally to be calculated by reference to the aggregate net income of husband and wife ; this aggregate net income is understood to be the net incomes remaining after deduction in each case of Income Tax and Super Tax payable on the incomes, and the alimony is payable in full.

Where this principle has *not* been followed in calculating the amount of the alimony, and where it has *not* been expressly stated that the alimony is to be paid " in full," or " without deduction of Income Tax," or " Free of Tax " (in all of which cases the alimony is payable in full), tax should be deducted from the amount of the alimony as from an ordinary annual payment.

Where alimony is payable under deduction for tax, the gross amount is retained in charge against the husband's income.

If tax is *actually* deducted by the husband, the alimony is treated in a statement of total income of the wife in the same way as taxed dividends.

If tax has *not* actually been deducted by the husband, the alimony is treated in the hands of the wife as fully taxed, *but no repayment may be claimed thereon.*

These remarks apply equally to weekly payments of alimony made under a magistrate's separation order.

It may happen that in connection with the payment of interest no provision is made regarding deduction of tax, i.e. whether the interest is to be paid under deduction for tax or free of tax. In such cases, where, although tax has

been retained on the interest in dealing with the payer's liability, no tax has, in fact, been deducted by the payer, the interest *in the hands of the recipient* is treated as fully taxed. It is, however, not available for repayment but may be treated as available to cover retainable charges.

The 1927 Finance Act contains special provisions regarding the payment of copyright royalties to persons resident abroad.

By these provisions persons by or through whom such payments are made are required to render an account to the Commissioners of Inland Revenue for the use of the Special Commissioners of the payments so made by them. Thereafter assessments will be raised on these figures to recover the tax which the payers are required to deduct from the royalties at the time of payment.

Deduction of tax from such royalties takes effect with regard to all payments made on or after 1st July 1927, or to payments made during the period from 11th April 1927 to 1st July 1927 to account of sums due on or after 1st July 1927 to persons whose usual place of abode is not within Great Britain or Northern Ireland.

For the purpose of collection of the tax arising on those payments, Rule 21 of the Miscellaneous Rules applicable to all Schedules—covering the recovery of tax on annual payments not payable out of profits or gains brought into charge—is made applicable to those payments and gives the person making the payment the right to deduct the tax and account for the tax so deducted.

An account of such payments is to be rendered, in the first instance to the local Inspector for the payer's Income Tax District showing the payments made and the tax deducted. This information will be transmitted by that official for further action thereon by the Board of Inland Revenue. Tax is deductible at the standard rate in force at the time of payment.

The class of payments coming within the scope of the provision does not include copyrights on any dramatic work being a cinematograph production or on any artistic work being a photograph intended to be used for the purpose of the exhibition of pictures or other optical effects by means of a cinematograph or other similar apparatus.

Deduction of tax will only be required where the payment is a royalty or sum payable periodically. A lump sum paid to a foreign author in outright purchase of copyright does not constitute a royalty within the meaning of the provision.

Payments in the ordinary course by owners of newspapers or periodicals to contributors abroad for news items, articles, &c., are not within the term " royalties."

It should be noted that the payments required to suffer tax by deduction are those made to or on behalf of persons whose usual place of abode is not within Great Britain or Northern Ireland.

The intention of the section is obviously to ensure the collection of British Income Tax on income of copyright owners who live wholly abroad, or whose visits to this country are not of sufficient frequency or duration to enable them to be considered as persons having their usual place of abode in this country.

It will be seen that it is possible for a person to own a house here and to be resident here and at the same time not to have his usual place of abode here.

An allowance to the payer in his Financial Accounts and from the computation of his Income Tax liability will, of course, be made equivalent to the gross amount of the payments—these being separately assessed by the Special Commissioners in terms of the provision of this section.

CHAPTER XVII

CHARITIES, CLUBS, SOCIETIES & ASSOCIATIONS

CHARITIES

For Income Tax purposes a "*Charity*" means a body of persons or a trust established for *charitable purposes* only.

The words "charitable purposes" are to receive an interpretation according to their legal technical meaning, whereby in effect there are included within the scope of the term several purposes which are not popularly associated with those of a charity.

For Income Tax purposes charities or trusts established for charitable purposes may be classified as follows :—

Those for

(*a*) The relief of poverty.

(*b*) The advancement of education.

(*c*) The advancement of religion.

(*d*) Certain other purposes by which the *community* is benefited, and which do not fall within any of the foregoing classes.

In connection with (*d*) it should be noted that a trust may be for purposes which are beneficial to the community, and yet not charitable.

The expression " charity " for Income Tax purposes does not cover occasional alms-giving or relief of poverty and distress, within the popular conception of the term. Before a " charity " can be considered as such for Income Tax purposes, and become entitled to the reliefs and exemptions granted by statute to such bodies, the charity must be protected by a trust of a permanent character, and bound, by virtue of an irrevocable deed, to administer the funds accruing to it for charitable purposes ; thus it is only the revenues of established institutions and incomes of charitable endowments with which the Income Tax Act is concerned.

The various reliefs to which " charities " are entitled, whether by statute or by concession on the part of the Inland Revenue Authorities, may be summarised as follows :—

SCHEDULE A

The specific exemptions granted by Statute in respect of income assessable under this Schedule have already been enumerated under the chapter on Schedule A to which the reader is referred.

SCHEDULE B

For exemptions granted by Statute or concession under this Schedule reference should be made to the chapter on Schedule B.

SCHEDULE C

Exemption is granted under this Schedule to Charities in respect of Interest, Annuities or Dividends arising under this Schedule, forming part of the income of the Charity and devoted legally to charitable purposes, only in so far as such income is applied to those purposes.

SCHEDULE D

Exemption under this Schedule is granted to Charities in respect of the following types of income :—

(*a*) Profits of a trade carried on by the charity provided that

(1) The trade is exercised in the course of the actual carrying out of a primary purpose of the charity (this expresses the extension contained in the Finance Act, 1927) ; or

(2) The work in connection with the trade is mainly carried on by beneficiaries of the charity, and the profits are applied solely to the purposes of the charity.

(*b*) Yearly interest or other annual payments forming part of the income of the charity, applicable by obligation on the charity to charitable purposes and in so far as they are so applied.

(*c*) Interest other than annual interest, e.g. Bank Deposit Interest, Treasury Bill Discounts, applied solely to charitable purposes. This relief is not expressly granted by statute but is covered by Revenue practice.

With regard to reliefs in respect of income assessable under Schedule A, the following points should be noted :—

A self-supporting institution is not to be considered as coming within the category of " hospitals, public schools or almshouses " to which the relief applies.

Relief or exemption only applies in those cases where there is a *substantial element* of charitable endowment ; on the other hand, relief is not rendered inoperative where a part (provided it is not a substantial part) of the income of the " charity " is received from fees, &c., charged for services given.

Claims for exemption or relief by charities must be made, in England to the Chief Inspector of Taxes (Claims), London, and in Scotland to the Chief Inspector (Claims), Edinburgh.

CLUBS, SOCIETIES AND ASSOCIATIONS

Clubs, Societies and Associations, where they have income liable to assessment, are in the same position as ordinary

individuals (but like a company or other corporate body are not entitled to personal allowances or reliefs). If the club, &c., is a charity, claims may be made for the exemptions granted by statute to charitable bodies. Where a club, &c., is in receipt of interest—even if the club, &c., is *not* trading—it must suffer tax in respect of such interest either by direct assessment or by deduction. *Liability under Case I, Schedule D, only arises if the club, &c., is a trading concern*, and for this purpose it must be established that it is carrying on a trade. It is a canon of Income Tax law that a person cannot make a profit from himself; before there is trading for Income Tax purposes there must be two distinct parties in the transactions.

If the club, &c., sells only to its proprietors or members, even if a surplus on those transactions arises, no liability under Case I issues, as the persons to whom the sales are made are *identical* with the parties by whom the sales are made. If, however, the club, &c., is not exclusively a membership club and sells to non-members, liability under Case I arises because there is not complete identity between sellers and buyers. In such cases the club, &c., is assessable in the ordinary way on the surplus of receipts over expenses. If the whole of the club's, &c., activities are not confined to trading, then only the expenses incidental to the trading and properly chargeable against the trading receipts will be allowed as a charge against these receipts.

Members' subscriptions, where they are paid in return for the benefits or advantages in which the club trades, are to be included in the club receipts upon which the assessable profits are based; otherwise members' subscriptions should be excluded.

Working Men's Clubs, when registered as Friendly Societies, are granted the exemptions and reliefs applicable to such bodies.

A Golf Club is assessable under Schedule B for the conventional profits supposed to arise from the occupation of the ground (and also, of course, under Schedule A if it *owns* the ground). As a result of a decision in the *Eccentric Club* case (which was raised on a Corporation Profits Tax issue), the Revenue authorities are not now seeking to assess "membership" Golf Clubs on profits or surplus which may arise to them from the green fees of non-members.

Where the constitution of a club takes the form of a company whose shareholders are entitled to receive dividends on their shares, the club, &c., is, for Income Tax purposes, a trading concern and assessable on the profits or surplus realised. If, however, in terms of the constitution all shareholders are members, any surplus arising from the payments of shareholder members is not assessable profits, because the condition of trading, viz. that there must be two distinct contracting parties, is not fulfilled. The liability in such a case would be confined to the surplus arising on the dealings with non-members. The profit would be arrived at by allowing a proportionate part of the total expenditure of the club, &c. (exclusive of charges inadmissible for Income Tax), against the income from receipts from non-members. The proportion would normally be calculated on the ratio of receipts from non-members to the total club receipts.

A Co-operative Society is assessable as follows :—

(*a*) Under Schedule A in respect of all property owned.

(*b*) Under Schedule B in respect of land occupied.

(*c*) Under Schedule D *only* if it sells to non-members, *and* the number of its shares is limited by its rules or practice.

The liability in this case is confined to the proportion of profits arising from trading with non-members.

CHAPTER XVIII

DOMINION INCOME TAX

The system at present in force with regard to relief for Dominion Income Tax was introduced by the Finance Act, 1920. The actual provisions expressing the conditions under which relief may be claimed, and the measure of relief to be given, do not appear to be very complicated, but many difficulties have arisen, both of procedure and practice, which have tended to make the application of the provisions a little difficult to comprehend. The purpose of the relieving section is easily understood, but the actual method of calculating the relief is encumbered by many difficulties.

The scope of the present chapter will be confined to a broad outline of the principles governing the relief and will not embrace the complexities of many individual instances of the relief ; these, to a large extent, have only been provided for by the Inland Revenue Authorities as the circumstances of the cases arose, and the whole atmosphere surrounding Dominion Income Tax relief is still very hazy.

The relief may be claimed by any person who has paid, by deduction or otherwise, or is liable to pay British Income Tax for any year of assessment, on any part of

his income which, for the corresponding Dominion Income Tax year, has suffered Dominion Income Tax.

In this connection it should be noted :—

(*a*) The relief may only be claimed on *that part* of income subject to British Income Tax which has also borne Dominion Income Tax. It does not follow, of course, that for any year of assessment *the part* of the income subject to British Income Tax—which income includes the Dominion income in respect of which tax is paid in the Dominion—will correspond identically with the amount on which Dominion tax is charged in the Dominion for the corresponding Dominion Income Tax year (this being due, for example, to the fact that the *basis* of assessment in the United Kingdom differs from that in the Dominion), but the amount on which relief may be claimed in the United Kingdom, for Dominion Income Tax relief, is the amount contained in the income subject to United Kingdom Income Tax which has suffered, or is liable to suffer, double taxation, i.e. British Income Tax and Dominion Income Tax.

(*b*) As the relief may be claimed by a *person*, a company, corporation, society, &c., is eligible to claim.

(*c*) The Dominion Income Tax year corresponding with the United Kingdom year of assessment, where the former does not end on the 5th April, is the Dominion year which ends within the United Kingdom year of assessment.

The *amount* on which relief may be claimed having been determined as above, the relief itself is to be calculated at the rate of either—

(*a*) The Dominion rate of tax, or

(*b*) *One-half* of the claimant's *appropriate rate of British tax, whichever is the less* for the year of assessment. For the purposes of calculating the relief, the Dominion rate of tax includes both any Income Tax and Super Tax charged

under a law in force in the Dominion, so long as these are analogous to the Income Tax and Super Tax charged in the United Kingdom.

The Dominion rate of tax, for purposes of Dominion Income Tax relief, is calculated by dividing the amount of tax paid in the Dominion by the amount of the income *in respect of which* the Dominion Income Tax is charged for that year ; this amount is, therefore, *inclusive* of allowances granted by way of personal or other reliefs in the Dominion, but is *exclusive* of allowances made for depreciation or amortisation.

The *appropriate rate* of British tax is the rate at which the claimant is liable to suffer tax for the year of claim, plus the rate at which he is liable to pay Super Tax for *that* year (irrespective of the fact that the income, on which Super Tax for that year is to be paid may not contain any Dominion income which has suffered Dominion Income Tax).

In the case of an individual, the rate of British Income Tax is obtained by dividing the tax payable on his taxable income (before allowance is made for Life Assurance or Dominion Income Tax relief) by his taxable income (which, of course, is the assessable income reduced by the claimant's appropriate personal, &c., allowances).

The rate of British Super Tax is obtained by dividing the amount of the Super Tax payable by the total income as estimated for Super Tax.

In the case of an individual, the minimum British rate of Income Tax will, therefore, be one-half the standard rate of tax, and this, in turn, will also be the minimum *appropriate* rate of British tax.

In the case of a limited company, the rate of British tax will be the *standard* rate of tax (since no part of the

taxable income of a company is charged at the half-standard rate of tax), and this, in turn, will be the *appropriate* rate of British tax.

The whole system of relief in respect of Dominion Income Tax contemplates a condition of affairs, with regard to taxation generally, where each dominion will grant a *reciprocal relief* in respect of the British tax suffered on the income assessed in the Dominion, which has also been subject to British tax. At the present moment this position does not obtain in all the Dominions.

Where Dominion Income Tax relief is claimed in respect of the tax paid in a Dominion which grants reciprocal relief for British tax, no deduction is made, in arriving at the gross amount of income liable to British Tax, for the tax paid *in the Dominion*.

Where, however, no system of reciprocal relief is in operation in the Dominion, a deduction will be admitted from the gross amount of income liable to British tax equivalent to the excess of the Dominion tax paid over the relief to be given in respect of the Dominion Income Tax.

The condition precedent to a claim for Dominion Income Tax relief is that Dominion Income Tax shall have been paid for the year of assessment for which the claim is sought to be made.

Claims for Dominion Income relief may be made by three classes of persons :

(*a*) United Kingdom companies.

(*b*) Agents for Dominion companies who distribute the dividends, &c., to the persons in the United Kingdom entitled to them (under deduction, of course, for Income Tax), and who may claim the Dominion Income Tax relief on behalf of the persons entitled to the dividends.

(*c*) Individuals residing in the United Kingdom.

The first two classes comprise the simple straightforward type of claim. Relief is given, on the proper amount of the income liable to British tax, at the proper rate according to the provisions prescribed by the Act and indicated above. Where such relief has been obtained by a company or paying agent, the relief so granted must be passed on to the shareholder or person entitled to the income. The rate of relief granted to the body, however, may not correspond with the rate of relief to be passed on to the individuals entitled to the income, because such relief will have been granted only in respect of income derived from a Dominion, and this may form only part of the total income available for distribution by the company, &c.,

e.g.—A company's total income for the year 1927-28 may have been £16,000, and it may have received Dominion Income Tax relief at 2s. (one-half the standard rate = one-half company's appropriate rate, the actual rate of Dominion Income Tax having been greater than this) on the sum of £8,000, a total relief of £800 (2s. × 8,000) ; this relief would be spread over the company's total income of £16,000 and would be equivalent to an effective rate of relief of 1s. per £ (800 ÷ 16,000) ; in paying the relative dividends, therefore, the company would only be entitled to deduct British tax at the rate of 3s. in the £ (i.e. 4s. standard rate less 1s., for Dominion Income Tax relief).

The case of an individual's claim for Dominion Income Tax relief is, however, slightly more complicated. When relief for Dominion Income Tax has been given to a United Kingdom company, the latter, in paying its dividends, passes on the relief at the effective rate to its shareholders and deducts British tax at a rate equivalent to the full standard rate reduced by the effective rate of relief.

The manner in which the rate of British tax deducted has been calculated is usually shown on the back of the Dividend Warrant as follows :—

Full standard rate of British Income Tax (say)	4/-
Less Relief in respect of Dominion Income Tax (say)	1/-
Rate of British Income Tax deducted ..	3/-

The relief in respect of Dominion Income Tax granted to the company will have been calculated, as provided by the Act, by reference to either—

(*a*) The rate of Dominion Income Tax suffered, or

(*b*) One-half the company's appropriate rate (i.e. one-half standard rate) of British tax,

whichever is less.

It may happen that the relief passed on by the company to the individual is *excessive* in the case *of the latter*, where the amount of relief received by the individual is more than one-half his appropriate rate of British tax, or *insufficient* in the case of the individual, where the amount of relief received by the latter is less than one-half his appropriate rate.

The company may have received relief for Dominion Income Tax with reference to one-half the standard rate of tax (i.e. one-half its appropriate rate), in which case the rate of Dominion Income Tax would exceed one-half the standard rate of British Income Tax.

The relief, when passed on by the company to the individual, may be excessive or insufficient by reference to the *individual's* one-half appropriate rate.

(*a*) If the individual's *appropriate* rate exceeds the standard rate of tax (i.e. in the case of a Super Tax payer), and

(1) The rate of relief to the company *has not* been restricted (i.e. where the rate of relief has been calculated by

reference to the rate of Dominion Income Tax because the latter was less than the company's half-appropriate rate, or one-half the standard rate of British Income Tax),

no further relief is due to the individual because there again, in his case, the relief is calculated by reference to the rate of Dominion Income Tax since the latter is less than is half-appropriate rate.

(2) The rate of relief to the company *has* been restricted (i.e. where relief has been given to the company by reference to its half-appropriate rate because the latter was less than the rate of Dominion Income Tax), further relief will be due to the individual by reference to (1) the full rate of Dominion Income Tax ; or (2) the *individual's* half-appropriate rate, whichever is less.

That is to say, the individual may claim additional Dominion Income Tax relief to make up the relief passed on to him by the company, to an amount equal to the full rate of Dominion Income Tax or his half-appropriate rate, whichever is less.

(*b*) If the individual's appropriate rate is less than the standard rate of tax and

(1) The rate of relief to the company *has not* been restricted (because the full rate of Dominion Income Tax has been less than the company's half-appropriate rate),

the individual will have received *excessive* relief, where the rate of relief passed on by the company exceeds the *individual's half-appropriate rate.*

(2) The rate of relief to the company *has* been restricted (because the half-appropriate rate of the company has been less than the full rate of Dominion Income Tax), the individual will have received *excessive* relief to the extent of the *difference* between the rate of relief allowed to the company and the individual's half-appropriate rate.

Any excess relief is to be adjusted in allowing the relief on the first £225 of taxable income.

A recent alteration of the Indian Income Tax law takes effect from 1928-29. The basis of liability to Indian Income Tax is the income of the previous year.

Until 1927-28 relief from Indian Income Tax dependent on total income was given to any person wherever resident by reference to the income accruing, arising, or received in British India.

From 1928-29 (for which year the liability to Indian Income Tax is based on the actual income of 1927-28) relief will be given to a person *not resident* in British India, under the following conditions :—

(1) By reference to the total income *wherever* accruing, arising, or received, and

(2) only if such person is a British subject or a subject of an Indian State.

In consequence of this alteration, the rate of Indian Income Tax payable by persons eligible to claim Dominion Income Tax Relief in this country for 1928-29 and future years will, in most cases, be higher than for 1927-28 and previous years.

Special provisions with regard to the relief for double taxation in respect of British Income Tax and Super Tax and Irish Free State Income Tax and Super Tax have effect from the year 1926-27 onwards. These are based on an agreement entered into between the British Government and the Government of the Irish Free State, and have effect in the granting of relief or exemption from British Income Tax and Super Tax for 1926-27 and any subsequent year for which an Act of the Legislature of the Irish Free State grants corresponding exemption or relief from Irish Free State Income Tax and Super Tax.

The special treatment granted in this case is no doubt the result of the peculiar relationship existing between the Irish Free State and Great Britain and Northern Ireland and the community of interests—social, industrial and commercial—of a considerable number of persons in the two countries.

The principle of the agreement entered into between the two countries is that each country (Great Britain and Northern Ireland on the one hand and the Irish Free State on the other hand) will—

(1) Grant exemption from its Income Tax and Super Tax in respect of income arising in its country to persons who are not resident in its borders but are resident in the other country

(this exemption will be effected either by refraining from assessing the income or by repayment of the tax on the income),

and

(2) grant relief from double taxation to persons resident in both countries in respect of the income which is taxed by both. The relief in this case will be granted in accordance with the existing provisions for Dominion Income Tax relief as they are expressed in Section 27, Finance Act, 1920, with the following modifications :

(*a*) Each country will give relief at one-half of the lower of the taxpayer's two appropriate rates of tax, British and Irish Free State ;

(*b*) For the purpose of determining the " appropriate rate," the rate of Income Tax in each country will be ascertained, not by reference to taxable income, but by reference to total income.

It is also provided

(1) that Irish Free State Income Tax (if enacted by Irish Free State legislation, and subject to any exemption and reliefs to which the recipient of the income may be

entitled under the Irish Free State laws regarding Income Tax) is to be charged on all income arising in Great Britain or Northern Ireland to persons resident in the Irish Free State.

(2) that British Income Tax (subject to similar conditions) is to be charged on all income arising in the Irish Free State to persons resident in Great Britain or Northern Ireland.

For the purposes of this agreement a company is to be deemed to be resident in that country in which its business is managed and controlled.

Briefly, therefore, the effect of the provisions is that

(1) a person resident in the Irish Free State will be exempt from British Income Tax and Super Tax on his British income ;

(2) a person resident in Great Britain or Northern Ireland will be exempt from Irish Free State tax on his Irish Free State income ;

(3) a person resident in both countries will be assessed according to the Income Tax laws of both countries in the ordinary way and may claim Dominion Income Tax relief in both countries in respect of that part of his total income subject to double assessment, that is, both in Great Britain and in the Irish Free State.

The following important modifications of the existing British Income Tax laws, when applied to Irish Free State subjects of assessment, should be noted :—

(1) The full amount of income under Cases IV or V, Schedule D, is subject to assessment, irrespective of the domicile or ordinary residence of the recipient, which ordinarily affects liability under those cases.

(2) Income from Irish Free State stocks, shares, and rents is chargeable on the income of the year of assessment.

(3) Income from possessions in the Irish Free State, other than stocks, shares, or rents, is chargeable to tax on the full amount (subject to the deduction of annual payments made out of it to persons abroad).

(4) Income from property in the Irish Free State remains assessable under Case V, even in circumstances where there is actually no income to the owner in Britain, e.g. property owned in the Irish Free State and not occupied either by the owner or a tenant but still assessable in the Irish Free State under Schedule A, is assessable under Case V, Schedule D, British Income Tax laws, at a figure which represents the net annual value of the property for Irish Free State Income Tax purposes.

(5) Allowance is made in the computation of assessments under Schedule D in respect of the profits of a trade to cover the annual value of Irish Free State premises used for the purposes of the trade, notwithstanding the provision in the existing Income Tax laws regarding premises situated abroad.

The following are examples of typical claims of a simple nature for Dominion Income Tax relief :—

EXAMPLE I

(*a*) A.'s statement of total income for 1927-28 was as follows :—

Taxed income from Corporation Stock (tax deducted) gross	£150
War Loan Interest	100
Income from Foreign Securities from Dominion X., calculated on net amounts received after deduction of Dominion Income Tax ..	50
	£300

A. was a bachelor and entitled to P.A. £135 and R.R. £225. The rate of Dominion Income Tax for 1927-28 is 1s.6d. in the £ and the Dominion grants reciprocal relief.

The gross amount of income from foreign securities liable to assessment to British Income Tax would be calculated thus :—

$$50 \times \frac{20}{18/6} = £54$$ (i.e. the amount *inclusive* of the Dominion Income Tax suffered).

A.'s total statutory income will therefore be £304.

A.'s half-appropriate rate of British Income Tax is 1s. (one-half of 2s.), since he is not liable at the standard rate on any of his income, and as this is less than the actual rate of Dominion Income Tax (1s.6d. in the £), he will be entitled to Dominion Income Tax relief on £54 at 1s. or £2 14s.

EXAMPLE II

(*b*) A. carries on business in the United Kingdom and in Dominion X and is assessed under Case I, Schedule D, for the year 1927-28 on his business profits on the sum of £3,000, being the profits of the preceding year. The Dominion profits included in the £3,000 is £500.

A. had no other income outside his business, and for 1927-28 was entitled to allowances as follows :—

P.A.	.. ..	£225
Ch.	.. ..	36
R.R.	.. ..	225
L.A.	.. ..	20 @ 4/.

It is required to show the amount of Dominion Income Tax relief which A. is entitled to claim for 1927-28.

Vouchers are produced by A. to show that Dominion Income Tax has been paid or will be paid at 3s. in the £ for

the Dominion year to 30th September 1927 (corresponding to Income Tax year 1927-28).

Calculation of A.'s appropriate rate of British Income Tax :

Liability as above			£3,000
Less : E.I.R.	£200		
P.A.	225		
Ch.	36	—	461
Taxable Income			£2,539

Tax thereon :--

225 @ 2/	£22	10	0
2,314 @ 4/	462	16	0
	£485	6	0

N.B.—Allowance for L.A. is ignored in calculation of appropriate rate.

∴ Rate of Income Tax for appropriate rate $\frac{£485\ 6\ 0}{£2,539\ 0\ 0}$ = 0 3 $9\frac{3}{4}$

For the same year A.'s rate of Super Tax (calculated for appropriate rate) is .. £0 0 8

∴ A.'s appropriate rate is .. .. .. £0 4 $5\frac{3}{4}$

∴ One-half appropriate rate .. .. 2/$2\frac{7}{8}$

This is less than the rate of Dominion Income Tax, viz. 3s.

∴ A. is entitled to relief as follows :—

£500 @ 2/$2\frac{7}{8}$, say £55 19 10

EXAMPLE III

(*c*) X.'s total income for 1927-28 was as follows :—

Taxed Dividends (British)	£1,500
Taxed Dividends from a company in Dominion P. and taxed by deduction for British Income Tax—amount before deduction for British Income Tax but without addition for Dominion Income Tax	700
	£2,200

X. was unmarried and entitled to the following allowances:

P.A.	£135
R.R.	225

The rate of British Income Tax deducted from the Dominion dividend, by the paying agent in the United Kingdom, was 2s. in the £, because relief for Dominion Income Tax had been allowed to him at 2s. in the £ (by reference to the half-appropriate rate, i.e. half standard rate, 2s.).

British Income Tax had been deducted from the gross dividend *after* the addition of the amount of relief allowed, calculated as follows :—

700 (net after deduction of D.I.T.) $\times \frac{20}{18/-}$ (i.e. 20s., less 2s. relief)=say £779.

X. is entitled to further relief in respect of Dominion Income Tax, which would be calculated as follows :—

Dominion P. does *not* grant reciprocal relief.

X.'s rate of Super Tax for 1927-28 is 1s. 0d.

X.'s *appropriate* rate is obviously more than 4s. in the £, and, therefore, his half-appropriate rate is more than 2s., the half-appropriate rate by reference to which the agent has had relief for Dominion Income Tax indicating, therefore, that the actual rate of Dominion Income Tax is greater than 2s. in the £, and that Dominion Income Tax relief to the agent has been restricted.

On inquiry, it is found that the full rate of Dominion Income Tax is 3s.

It has, therefore, to be ascertained whether the actual rate of Dominion Income Tax, viz. 3s. in the £, is less than X.'s half-appropriate rate or *vice versa*.

Assume the rate of Dominion Income Tax relief due to X. to be 2s.6d. (half the standard rate of Income Tax, plus half the Super Tax rate, viz. half (4s. + 1s. 0d.)).

The amount of Dominion income will therefore require to be grossified accordingly :—

$$\text{i.e. } 700 \times \frac{20}{17/6} = \text{say } £800.$$

Calculation of A.'s appropriate rate :—

Total Income—	
From British Sources	£1,500
„ Dominion Sources	800
	£2,300
Less P.A.	135
	£2,165

Tax thereon :—

225 @ 2/-	£22 10 0
1,940 @ 4/-	388 0 0
	£410 10 0

∴ Appropriate rate of Income Tax .. .. $\frac{£410\ 10\ 0}{£2,165}$ = say 3/9

Add: appropriate rate of Super Tax .. 1/0

∴ Appropriate rate for Dominion Income Tax relief purposes 4/9

∴ One-half rate for Dominion Income Tax relief purposes 2/4½

∴ X.'s rate of relief for Dominion Income Tax purposes is 2s. 4½d., this being less than the actual rate of Dominion Income Tax suffered.

∴ X. is entitled to a further relief in respect of Dominion Income Tax on £779 × 4½d. (i.e. 2s. 4½d., less 2s. already allowed).

It should be noted, however, that the correct gross amount of Dominion income for British Income Tax purposes will require to be corrected in view of X.'s ascertained half-appropriate rate, by reference to which Dominion Income Tax relief is due to be granted.

The correct gross amount of the Dominion income liable to British Income Tax will therefore be :—

700 (the net Dominion income) × $\frac{20}{17/7\frac{1}{2}}$ (i.e. 20s., less 2/4½)=say £794.

It follows, therefore, that A. has been *undercharged* to British Income Tax in so far as British Income Tax has been deducted on the gross calculated by the paying agent as £779, whereas the correct gross is £794, making an undercharge to British Income Tax of £15 (viz. £794—£779) at 1s. 7½d. (viz. 4s., less 2s. 4½d.).

The total additional Dominion Income Tax relief to which X. would be entitled would be :—

Additional relief for Dominion Income Tax—

£779 @ 4½d. =	£14	12	1½
Less: British Tax due on undercharge, £15 @ 1/7½=	1	4	4½
Relief	£13	7	9

CHAPTER XIX

SUPER TAX AND SUR TAX

The financial year for Super Tax purposes is the same as for Income Tax, i.e. from 6th April one year to the 5th April following, and liability arises on an individual whose *total income for the year for Super Tax purposes exceeds* £2,000. In this connection total income for Super Tax purposes is the *total income for Income Tax purposes for the preceding year*, e.g. Super Tax liability for 1928-29, i.e. year ending 5th April 1929, is based on the total income for Income Tax purposes for the year 1927-28.

It should be noted that the income for Income Tax purposes, which determines the Super Tax liability for the succeeding year, is the total income as finally adjusted in consequence of any claims or reliefs as provided in the Income Tax Acts, e.g. after adjustments in respect of specific cause claims, cessation claims, &c. &c., together with the investment income of the preceding year.

Limited companies, corporations, and similar bodies, are not liable to Super Tax except in the circumstances mentioned later.

An individual resident abroad whose total income arising in this country exceeds £2,000 is liable to Super Tax in the ordinary way in respect of such income.

Partners in a firm are liable to Super Tax as *individuals* by reference to their total incomes, which, of course, will include their respective shares of the firm's profits.

Income Tax assessments as finally adjusted are final and conclusive with regard to the determination of Super Tax liability.

Super Tax assessments are made by the Special Commissioners, 23 Kingsway, London, by whom all Return Forms, Assessment Notices, &c., are issued and the tax is payable direct to the Accountant and Comptroller-General.

For Super Tax purposes, as for Income Tax purposes, the income of a wife is considered to be the husband's income, although, as for Income Tax purposes, application may be made by the husband and the wife for separate assessment. This involves no relief beyond an apportionment of the total Super Tax liability between the husband and the wife in proportion to their respective shares of the total income.

With regard to the Super Tax liability of husband and wife for the year following the year in which the marriage took place, it should be noted that the wife remains assessable in her own name in respect of the income arising to her in the previous Income Tax year up to the date of marriage, and the liability of the husband includes his wife's income from the date of marriage to the 5th April following.

Where an individual dies before the end of the year, liability will be restricted to the period of the year during which the individual was alive. The apportionment will be made on a time basis.

In arriving at the total income for Income Tax purposes for determination of the Super Tax liability of the succeeding year, the amount of taxed income—i.e.

income received under deduction for tax, e.g. dividends, the gross amount of which falls to be included in the statement—to be taken into account, is the total amount *received in the Income Tax year*, irrespective of the period for which, or the profits out of which, the payments were made.

In any year of assessment the taxpayer has the option of claiming to have his personal allowances deducted from his Income Tax liability *or from his Super Tax liability for the same year.* Allowances which cannot be claimed from Super Tax and must, therefore, be allowed in computing Income Tax liability are (*a*) Earned Income Relief and (*b*) reliefs which are given in terms of tax, i.e. Life Assurance and Dominion Income Tax reliefs.

Further, where an individual makes a return of Total Income for Super Tax purposes for any year, he is not obliged to make a full return of income for Income Tax purposes for the same year, provided he gives details of the total amount of his earned income (this is furnished on a Form No. 41 S.T., specially provided for the purpose and enclosed in all Income Tax forms issued to Super Tax payers), and other untaxed income liable to assessment locally. Where circumstances arise necessitating a return of Total Income for Income Tax purposes, e.g. in connection with claims for relief, the Super Tax payer may give the Inspector the necessary authority in writing to apply to the Special Commissioners for the required information.

From 1929-30 inclusive returns of total income will require to be furnished locally to the District Inspector. It was found that there was considerable evasion of Super Tax liability as a result of the failure of certain types of companies, e.g. private limited companies, to distribute profits as dividends. The profits were allowed to accumulate in the business and not infrequently escaped Super

Tax assessment altogether by the resort to the device of distributing the surplus as bonus shares or in some other way that was interpreted in law as a distribution of assets or a reconstruction of capital.

The first attempt to defeat this policy of evasion was expressed in Section 21 of the Finance Act, 1922, but the provisions of that Act have now been superseded or amplified by Sections 31 to 37 of the Finance Act, 1927.

The following resumé of the existing provisions will explain the extent to which Super Tax liability may be attached to profits or income which, in certain circumstances, do not reach the persons entitled to participate therein at the time when the liability is assessed :

With a view to preventing the avoidance of the payment of Super Tax through the withholding from distribution of income of a company which would otherwise be distributed, it is enacted that :—

" (1) Where it appears to the Special Commissioners that any company to which this section applies has not, within a reasonable time after the end of any year or other period ending on any date subsequent to the fifth day of April nineteen hundred and twenty-two, for which accounts have been made up, distributed to its members in such manner as to render the amount distributed liable to be included in the statements to be made by the members of the company of their total income for the purposes of Super Tax, a reasonable part of its actual income from all sources for the said year or other period, the Commissioners may, by notice in writing to the company, direct that for purposes of assessment to Super Tax, the said income of the company shall, for the year or other period specified in the notice, be deemed to be the income of the members, and the amount thereof shall be apportioned among the members (and Super Tax shall be assessed and charged under the provisions of this section in respect of the sum so apportioned after deducting in the case of each member any amount which has been distributed to him

by the company in respect of the said year or period in such manner that the amount distributed falls to be included in the statement of total income to be made by that member for the purposes of Super Tax)."

In those cases where the member of a company, the income of which for any year or period has been deemed to be the income of its members and has been subject to an apportionment, is itself a company to which the same provisions apply (i.e. regarding non-distribution of income), liability arises to the second company on the amount apportioned to the second company diminished by the amount received by the second company out of the income of the first company which was made liable to Super Tax ; and so on through any chain of interconnected companies liability arises to each company coming within the scope of the provisions governing non-distribution of income, allowance being made for any part of the income of the company received from another company and which had already been subject to Super Tax on apportionment.

Each successive company whose income is the subject of Super Tax liability under these provisions is required to make statements on separate returns to the Special Commissioners of the names and addresses of its members and the respective interests of the members.

The following considerations are given effect to in determining whether liability to Super Tax arises on the undistributed income of certain companies.

In determining whether any company has or has not distributed a reasonable part of its income, regard is had not only to the current requirements of the company's business, but also to such other requirements as may be necessary or advisable for the maintenance and development of that business.

Generally speaking, the following sums are to be regarded as income available for distribution and not as having been applied or applicable to current requirements or to the development of the business :—

(*a*) Any sum expended or applied or intended to be expended or applied out of the income of the company otherwise than in pursuance of an obligation entered into before 4th August 1914 for one of the following purposes :—

(1) to pay for the business acquired by the company or for the first business of the company ; or

(2) in redemption of Share or Loan Capital or debt incurred in the purchase of such business ; or

(3) in meeting any obligations connected therewith.

(*b*) Any sum expended or intended to be expended in connection with any fictitious transaction.

Super Tax chargeable under these provisions on the income of the company apportioned to its members is assessed upon the members of the company—according to their interests in the company—and is payable by the company. The ordinary provisions regarding assessment, collection, and recovery of Super Tax apply to assessments made under these provisions.

Any undistributed income which has been assessed and charged to Super Tax under these provisions is, when subsequently distributed, deemed not to form part of the total income from all sources of the recipient for the purposes of Super Tax.

The provisions regarding the assessment to Super Tax of undistributed income of companies provide that they shall apply to a company which is under the control of not more than five persons and which is not a subsidiary company or one in which the public is substantially interested. For this purpose, a subsidiary company is defined as one in which the control is in the hands of one or more companies to which the provisions do not apply. The public are deemed to be substantially interested in a company where shares (not being shares entitled to a fixed rate of dividend with or without further participation) carrying not less than 25 per cent. of the voting power, have been allotted unconditionally to or acquired unconditionally by and are

at the end of the period in question beneficially held by the public. It is further provided that such shares must during the year in question have been the subject of dealings on a Stock Exchange in the United Kingdom and officially quoted by such Stock Exchange.

In the case of a company applying to be wound up, the income for the period from the date of the last accounts to the date of the order is deemed to be distributable (Finance Act, 1927, Section 31 (4)); notices may be served on the liquidator and he is responsible for the making of the appropriate returns.

Where the Special Commissioners have issued a notice to a company requiring particulars of income, &c., or have made a direction against that company, the directors may make a declaration to the Special Commissioners who, in turn, may submit the declaration to the Board of Referees, together with a statement by themselves and a counter-statement by the Commissioners of Inland Revenue. The Board of Referees' decision as to whether or not there is a prima facie case is final (Finance Act, 1927, Section 31 (7)).

Where a direction is made by the Special Commissioners under these provisions, the income as apportioned among the members of the company is to be treated as if received by the members at the date to which accounts are made up, or in the case of a company being wound up at the date of the order. The Special Commissioners have power to alter this date if they think it just, so as to avoid the inclusion of two years' income in one return.

Section 33, Finance Act, 1927, is designed to prevent a further evasion of Super Tax liability by sales of investments cum dividend. Under this section the Special Commissioners may serve on any individual a notice requiring him to furnish a statement of, and particulars relating to, any assets in which at any time during the period specified in the notice he has had any beneficial

interest and in respect of which within such period either no income was received by him or the income received by him was less than it would have been if the income from such assets had accrued from day to day. Such notices may be served as and when the Special Commissioners consider it necessary, until complete particulars have been furnished to their satisfaction.

If it appears to the Special Commissioners, after having considered all the circumstances of the case, that any individual, by reason of sales, purchases, dealings, contracts, arrangements, transfers, or any other transactions relating to the assets, has avoided or would avoid more than 10 per cent. of the amount of the Super Tax for any year which would have been payable if the income from those assets had been deemed to accrue from day to day and had been treated as part of his total income from all sources for Super Tax purposes, then those assets are deemed to come within the provisions of this section. The income apportioned on the accrued basis over the period concerned will be treated as part of the total income for Super Tax purposes of that period and liability to Super Tax will be assessed in accordance with the total income.

Section 34, Finance Act, 1927, provides for relief from Sur-tax for 1928-29 onwards where any income attributable to a period exceeding a year is received in any one year. The relief operates so as to treat the income from such source as accruing from day to day, if the amount of Super Tax or Sur-tax otherwise payable exceeds by more than 5 per cent. the Super Tax or Sur-tax which would have been payable if the income had been received regularly.

The corollary of the liability to Super Tax attaching to sales cum dividend is contained in Section 35 of the Finance Act, 1927, which provides for relief to Super Tax payers. In the case of purchases cum dividend where it is proved to the satisfaction of the Special Commissioners

that in consequence of the sale or transfer of any assets the amount of Super Tax payable for the year in which the purchases occur exceeds by more than 10 per cent. the amount of Super Tax which would have been payable for that year for which income from those assets and from any assets sold or transferred were deemed to have accrued from day to day ; for the purposes of relief the income from all such assets is deemed to have accrued from day to day and to have been received as and when it is deemed to have accrued.

All the foregoing provisions relating to the payment of Super Tax on undistributed income, liability to Super Tax on income from investments sold cum dividend, relief from Super Tax where income attributable to a period exceeding a year is received in a year, and relief from Super Tax in cases of purchases cum dividend, apply for the purposes of assessment to Super Tax from the year 1928-29. Super Tax liability ceases from 1928-29, i.e. the last Super Tax assessments will be made for the year 1928-29 on the total income of 1927-28.

The place of Super Tax will be taken by Sur-tax which is to be regarded as a deferred payment of Income Tax. The basis on which Sur-tax is to be levied follows the Super Tax basis and all the provisions in force with regard to the assessment of Super Tax for 1928-29 apply with regard to the assessment of Sur-tax.

It should be noted, however, that the first assessments to Sur-tax are for the year 1928-29, that is on the income of 1927-28.

In effect, therefore, a double liability to Super Tax and Sur-tax is to be created for 1928-29. Provision, however, has been made for the first payment of Sur-tax, i.e. on the 1928-29 Sur-tax assessments, to be delayed till 1st January 1930, or one year after the last payment of Super Tax (i.e. on the 1928-29 Super Tax assessments due for payment 1st January 1929).

Sur-tax will be payable on the 1st January in each year from 1930 onwards, the date for payment being, therefore, the 1st January next after the end of the year of assessment for which the tax is payable.

The effect, therefore, of the change over from Super Tax to Sur-tax is to create an additional year's liability (for 1928-29 there is a double charge created) although the effect of the double charge is not felt so far as payment is concerned until the death of the assessee. In that event the liability to be met will be—

(*a*) the Sur-tax for the year of assessment preceding the year of death (as this is not due for payment until the 1st January following the end of the year of assessment); and

(*b*) the Sur-tax due for the period of the year of assessment up to the date of death.

EXAMPLE

A.'s total income for Super Tax purposes for the year 1928-29 (based on his total income for Income Tax purposes for the year 1927-28) was £7,700, made up as follows:

(*a*) Business Profits		£5,900
(*b*) Ownership of Land (Net Schedule A) ..		350
(*c*) Occupation of Land		250
(*d*) Investment Income, Ground Rents, Mineral Royalties, &c. (gross)		1,100
(*e*) Bank Deposit Interest		50
(*d*) Wife's Investment Income (gross) ..		250
Carried forward ..		£7,900
Less Charges—		
Annuity to C. D.	£120	
Bank Overdraft Interest ..	80	
		200
		£7,700

Super Tax for 1928-29 would be payable as follows :—

First £2,000	Nil	
Next 500 at 9d.	£18	15 0
,, 500 at 1s.	25	0 0
,, 1,000 at 1s. 6d.	75	0 0
,, 1,000 at 2s. 3d.	112	10 0
,, 1,000 at 3s.	150	0 0
,, 1,700 at 3s. 6d.	297	10 0
	£678	15 0

For table of rates see front of book.

Section 18, Finance Act, 1928, enables a company within the scope of Section 21 of the Finance Act, 1922, as amended by the Finance Act, 1927, to submit its accounts, &c., to the Special Commissioners soon after the adoption of its financial accounts in general meeting and the declaration of dividends, in order that the Special Commissioners may decide what liability, if any, to Super Tax or Sur-tax arises in respect of the undistributed income. The Special Commissioners are allowed twenty-eight days within which they may call for such further particulars as they may reasonably require. The latter particulars in turn require to be furnished within a period of twenty-eight days.

If, within the period of three months after the receipt of the accounts and such other information as has been required, no notice is received from the Special Commissioners intimating their intention to take further action in the case of the company with regard to the assessment to Super Tax or Sur-tax of undistributed income, the matter of liability to Super Tax or Sur-tax in this respect is considered at an end for the year in question.

The object of these provisions is presumably to relieve a company from the risk of being faced with Super Tax (or Sur-tax) liability on undistributed income for several past years.

CHAPTER XX

RESIDENCE

The ordinary personal and family allowances and reliefs viz.:—

Earned Income,
Personal,
Wife's Earned Income,
Children,
Housekeeper,
Dependent Relative,
Reduced Rate,
Life Assurance, and
Age Relief

are granted only to individual taxpayers resident in Britain.

An exception, however, arises in the case of an individual not resident in Britain who can satisfy the Commissioners of Inland Revenue that he comes within one of the following classes:—

(*a*) A British subject.

(*b*) A person resident in the Isle of Man or the Channel Islands.

(*c*) A person who is, or has been, in the service of the Crown.

(*d*) A person who is employed in the service of any Missionary Society abroad.

(*e*) A person who is employed in the service of any native State under the protection of His Majesty.

(*f*) A person who, having previously resided in Britain, is resident abroad for the sake of his health or the health of any member of his family *resident with him*.

(*g*) A widow whose deceased husband was in the service of the Crown.

The tax to be borne by an individual coming within one of the above classes would be such an amount as bears the same ratio to the total Income Tax which would be payable (after granting all allowances and reliefs) on the *whole of the individual's total income* (whether arising in Britain or elsewhere), as the individual's income liable to British Income Tax bears to his total income whether liable to British tax or not.

For the purpose of arriving at the tax which would be payable if the individual were liable on the whole of his income, the computations are made in the same manner as for an individual resident in Britain, e.g.

A. is a British subject not resident in Britain, and for the year 1927-28 his total income and income subject to British Income Tax were as follows :

(*a*) Income from property situated in Britain—	
Net Schedule A Assessment	£500
(*b*) Total Income—	
(*a*) Income from foreign property and investments	£1,000
(*b*) Income from property in Britain as above	500
	£1,500

He was a married man and paid Life Assurance premiums of £20 per annum—policy post June 1916.

Tax payable by A. if total income were subject to British Income Tax :—

Total Income		£1,500
Less P.A.		225
		£1,275
Tax thereon :—		
225 @ 2/0	£22 10 0	
1,050 @ 4/0	210 0 0	
	£232 10 0	
Less : L.A., 20 @ 2/0	2 0 0	
	£230 10 0	

Tax to be paid by A. in consequence of relief to British subject resident abroad :—

500 (income liable to British tax) / 1,500 (total income) × £230 10 0		£76 16 8
Tax would have been paid by A. on his property situated in Britain : 500 @ 4/0		100 0 0
∴ A. is entitled to relief to the extent of		£23 3 4

Applications for relief under the foregoing provisions are to be made to the Chief Inspector (Claims).

An application to have claims under this heading dealt with by the Special Commissioners may be made in terms

of the provisions of Section 19, Finance Act, 1925, and by the Finance Act, 1926, Section 20. The time limit for such claims is extended to three months.

Certain British Government securities have been issued by the Treasury subject to the condition that, so long as the securities remain in the beneficial ownership of persons not ordinarily resident in Britain, the interest arising on the securities is not liable to British Income Tax. Such securities are :—

Per cent.

5 War Loan.
5 Exchequer Bonds, 1920 (paid off).
5 Exchequer Bonds, 1919 (paid off) and 1921.
6 Exchequer Bonds, 1920 (paid off).
5 Exchequer Bonds, 1922.
5 National War Bonds, 1st Series, 1922, 1924, and 1927.
5 National War Bonds, 2nd Series, 1923, 1925, and 1928.
5 National War Bonds, 3rd Series, 1923, 1925, and 1928.
5 National War Bonds, 4th Series, 1924 and 1929.
4 Funding Loan, 1960-90, at 80.
4 Victory Bonds issued at 85.
5¾ Exchequer Bonds, 1925.

Treasury Bills—issued from 10th March 1916 to 31st August 1922.

Two year war expenditure certificates (last issue 4th January 1917—issued after 11th August 1916).

It should be noted that the power granted to the Treasury to issue securities subject to the condition expressed above ceased as at 31st August 1922.

The following classes of income payable in Britain, where the person having the beneficial ownership of the sources from which the income arises and entitled to the income

is not resident in Britain, are exempt from British Income Tax, viz. :—

(*a*) Interest, dividends, &c., payable in respect of the shares, securities, &c., of a foreign or dominion company.

(*b*) Interest or dividends on securities of a foreign state or a British possession.

(*c*) Annuities, pensions, or other annual sums payable out of the funds of any institution in India.

The general question of Residence, so far as it affects liability to British Income Tax, still presents many difficulties, in spite of the provisions of the Income Tax Act with regard to this matter, and of the very considerable volume of Case Law which has grown up on this subject.

Residence is a factor of very considerable importance in the determination of Income Tax liability, both from the point of the persons liable to assessment and of the quantum of the liability.

In the first place, liability to Income Tax may be looked at from the point of view of (*a*) persons residing in Britain, and (*b*) persons not residing in Britain : there are specific rules and regulations governing both those classes of persons.

(A.) Persons residing in Britain.—Obviously this class will include those persons whose ordinary place of residence is in Britain (whether they have one or more residences elsewhere or not, and whether they are in the habit of leaving this country periodically for occasional visits abroad, or not), and those whose ordinary residence is not in Britain but who, either at the beginning of the year of assessment or at a time or times during the year of assessment, do actually reside in this country.

If a person is ordinarily resident in this country, then his Income Tax liability normally presents no difficulty, as he is assessable, according to the various provisions of the Income Tax Act, on all his income whether it arises in Britain or elsewhere.

Moreover, according to Rule 3 of the General Rules applicable to all Schedules, every British subject "whose ordinary residence has been in Britain shall be assessed and charged to tax, notwithstanding that at the time the assessment or charge is made he may have left Britain, if he has so left Britain for the purpose only of occasional residence abroad, and shall be charged as a person actually residing in Britain upon the whole amount of his profits or gains, whether they arise from property in Britain or elsewhere . . ., or from any trade, profession, employment or vocation in Britain or elsewhere."

On the other hand, Rule 2 of the Miscellaneous Rules of Schedule D provides that "a person shall not be charged to tax *under this schedule* as a person residing in Britain, in respect of profits or gains received in respect of *possessions* or *securities* out of Britain, who is in Britain for some temporary purpose only, and not with any view or intent of establishing his residence therein, and who has not actually resided in Britain at *one* time or *several* times for a period equal *in the whole* to six months in any year of assessment, but if such person resides in Britain for the aforesaid period, he shall be so chargeable for that year."

(B.) Persons not resident in Britain.—Such persons are chargeable only in respect of profits from any property in, or any trade, profession, &c., exercised *within* Britain.

It, therefore, becomes a question of paramount importance to establish whether or not a person is resident in Britain: *if residence in Britain* is established, liability arises on

all income wheresoever arising, i.e. in Britain or elsewhere; if *residence outside Britain* is established, then liability only attaches to income arising in Britain. (The exemption in favour of interest on War securities mentioned earlier in this chapter should be borne in mind as qualifying the general remarks made here.)

In determining the case of whether a person is resident in Britain or elsewhere, the position must be considered from the point of view of an individual and of a company or other corporate body. Generally speaking, it is easier to determine the place of residence of an individual than of a corporate body.

Again, the fact of domicile is not conclusive—indeed, it is of little importance—in determining the place of residence. Further, a person may have more than one residence, that is to say, " places to which it is quite easy for the person to resort as his dwelling place, whenever he thinks fit." In the case of an individual his residence is where he eats, drinks, and sleeps; in the case of a company or other corporate body, however, the place of residence is sometimes not so easily traced. The place where the company is *registered* is not conclusive in the matter of determining its *residence*, because it may be registered in several countries. The residence of a company is the place where " the *real* business is carried on, i.e. where the central management and control *actually* abides." This may be quite independent of the place where the actual trading operations are carried on, and likewise independent of the place where any sub-control or sub-management, e.g. vested in a local Board of Directors, is situated. On the other hand, if full control were vested in a local Board of Directors, the residence would follow the place where the local board exercised its managerial and directory functions. The place where ultimate control is exercised is the factor that decides the residence of a corporate body.

Further, it should be noted that it is not sufficient, to establish ordinary residence in Britain in the case of an individual, that the latter *has* a place of residence in Britain. Before liability as an ordinary resident in Britain arises, the individual must have resided at the residence during the year of assessment ; actual bodily presence at the residence is necessary in the year of assessment to attract full liability as an ordinary resident in Britain.

(The only apparent exception to this general statement is the case of an individual who, although not bodily present at his residence in Britain, had, during the year of assessment, no alternative residence elsewhere to which he resorted. This covers the case of e.g. a person on board a British ship and absent from Britain throughout the whole of the year of assessment, *cf.* the cases of *Commissioners of Inland Revenue v. Young* and *Rogers v. Commissioners of Inland Revenue.*)

The tendency in recent Case Law decisions on the question of residence as a determining factor in Income Tax liability has been to strengthen the Inland Revenue position.

With regard to individuals the following cases throw some light on the still somewhat obscure position.

A British subject, having no business interests in this country, and having been in employment up to 1920 in India from which he retired in that year, lived in hotels since then in Paris and Belgium ; certain periods of time he spent in this country on visits to his friends ; the periods never exceeded six months in any year of assessment ; it was held that he was not resident in Britain (*Commissioners of Inland Revenue v. Zorab*).

A British subject who, prior to 1916, had established a house in Glasgow with her two sisters, but who subse-

quently spent the greater part of each year travelling abroad for health reasons, revisited this country from time to time and lived in hotels at Glasgow or London ; the duration of the visits was less than six months in each Income Tax year. In the intervals between her visits abroad no residence was maintained here and no rooms were reserved. A bank account was kept in London and her personal effects were stored there. It was held that she was ordinarily resident in Britain. (*Reid v. Commissioners of Inland Revenue.*)

The cases of *Levene v. Commissioners of Inland Revenue*, *Lysaght v. Commissioners of Inland Revenue*, and *Lowenstein v. De Salis* should also be consulted in this connection.

In the case of an English company controlled abroad, all meetings of directors of the company were held at Cairo where the books of account, &c., were kept, made up, and audited ; at Cairo, also, the dividends were declared and paid, but the company was registered in Britain in order to meet the requirements of the Companies Act, and had a London secretary who provided them with a registered office at his own office, merely to comply with legal formalities in this country. It was held that the company was resident in Britain.

Certain observations of Mr. Justice Rowlatt in this case are worthy of note :—

(1) The mere fact of registration does not determine residence.

(2) Where the company has its control and management it resides, but not necessarily exclusively.

(3) It seems to me that the Companies Act puts on a company which is incorporated in England obligation to have a residence here.

(4) I think a company cannot be incorporated under the Companies Acts as an ambulatory being that can have no residence anywhere, or at any rate not a residence

where it has its registered office. (*Todd v. Egyptian Delta Land and Investment Co., Ltd.*)

This decision (viz. that the company was resident in the United Kingdom) which was confirmed by the Court of Appeal has recently been reversed by the House of Lords. It would appear, therefore, that the decision of the Supreme Court was influenced by consideration of the fundamental principle regarding the company's trading, viz. the seat of control, rather than by any accidental circumstance of the place of registration. In the course of the judgment it was remarked that the case involved the difficulty of applying to corporate bodies language (i.e. the rules governing assessment of residents and non-residents) designed to cover the cases of individuals.

The *period* of residence during the year of assessment is, however, quite immaterial in the case of a person who has a residence in Britain.

The circumstances determining the decisions in one or two cases may serve to make the application of the foregoing principles more easily understood.

An individual resided in Leghorn, where he carried on business. He had no place of business in Britain. He had also an estate in Scotland, and during the year of assessment had resided there from 16th July until 31st October. He was held to be a person residing in Britain, and fully liable on his profits or gains wheresoever arising.

A British merchant carried on business in Madras, where he usually resided. He also maintained a residence in Britain, where his wife and family lived. During the year of assessment he was never in Britain, and it was held that he was not liable as a person residing in Britain.

A company was registered both in this country and in Italy, where alone it carried on business. The business

operations were carried on under a local Board of Directors who were in constant correspondence with the main Board in this country, which had the ultimate control of the company's affairs. It was held that the company was resident in this country and fully liable as an ordinary resident in Britain on the whole of its profits.

A company was registered in Cape Colony, where it owned and worked diamond mines. The head office of the company was in South Africa, and the general meetings were held there. The majority of directors and governors, however, resided in England, and it was proved that the actual sales of the diamonds—as distinct from the mining operations—were really controlled by these directors in London. It was held that for Income Tax purposes the foreign company resided in Britain, the test of residence being " not where the company is registered but where it really keeps house and does business. The real business is carried on where the central management and control actually abides."

The liability to Income Tax of the person not resident in Britain presents another aspect of the case of residence. This class of person, as has been stated, is liable in respect of profits from any property in, or any trade, profession, &c., exercised within Britain. The difficulty with this class of person is usually confined to determining whether or not a trade is carried on within Britain as distinct from a trade carried on *with* Britain. No liability arises on the non-resident in respect of a trade carried on *with* Britain. The question of whether or not a trade is carried on within Britain is usually one of fact to be decided upon a consideration of the circumstances.

A dictum from the case of *Erichsen v. Last* is useful in the consideration of the question as to what constitutes trading within Britain. In that case it was remarked that " wherever profitable contracts are habitually made

in England by or for a foreigner with persons in England, because those persons are in England, to do something for, or supply something to, those persons, such persons are exercising a profitable trade in England even though everything done by them in order to fulfil their part of the contract is done abroad."

It follows, therefore, that the fact that contracts are made in this country is of paramount importance in determining whether the foreigner exercises a trade in this country. This principle has not been impugned in any of the numerous cases which have been decided on the subject of foreign traders in Britain.

Other factors which have been taken into consideration in determining whether or not a trade was exercised *within* Britain are (*a*) the place of payment for the goods, &c., and (*b*) the place of delivery.

In practice the place of payment is not particularly conclusive, as in many cases, although the foreign trader's invoice may bear directions as to payment to be made abroad, money may be accepted by the agent resident here, and remitted to the foreign principal by whom the receipt may be issued.

The place of delivery is of more importance, however, in determining whether or not a trade is carried on within Britain. The case of *Turner, Ltd. v. Rickman* established that even if the contracts had been made abroad, delivery of the goods in this country is sufficient to constitute trading within Britain.

The outcome of the variety of legal decisions on cases on the point would appear to lead to the conclusion that when either contract or delivery is made by the foreign trader in this country, he is to be regarded as carrying on a business in Britain.

There now remains to be considered the machinery that exists in order to enable the non-resident person to be

assessed to British Income Tax in respect of the profits arising in this country.

Normally, the non-resident carries out his trading transactions in this country through an agent, factor, branch, receiver or manager.

It should, however, be clearly understood that the machinery of assessment provided by Rules 5 to 13 of the General Rules applicable to all schedules is merely supplementary to the general machinery of assessment of the Income Tax Act. That is to say that where the foreign trader can be got at himself, in order to obtain from him a return of his income for assessment purposes or to deliver to him notice of assessment or demand notes for payment, assessment should be made on him and payment of the tax required from him. In ordinary circumstances, e.g. where the foreign trader has not a branch office in this country, where he is personally present at various times throughout the year of assessment, delivery of notices and actual payment of the tax by him would be difficult to effect.

The rules referred to above permit of non-residents being charged *in the name of* any branch, manager, factor, agent or receiver whether such a branch, manager, factor, agent or receiver *has the receipt of the profits or gains or not*, to the same extent as the non-resident person would be assessed in his own name.

A non-resident person is chargeable in respect of any profits or gains arising directly or indirectly through or from any factorship, agency, receivership, branch, or management, and is assessable and chargeable in the name of the factor, &c. &c.

Where a non-resident person (not being a British subject or a British, Indian, Dominion or Colonial firm or company, or branch thereof) carries on business with a resident

person, the latter may be assessed and charged for the non-resident, as his agent, where the Commissioners by whom the assessment is made, are satisfied that the following position obtains, viz. :—

That owing to the close connection between the resident person and the non-resident person and to the substantial control exercised by the non-resident person over the resident person, the course of the business between those persons can be so arranged, and is so arranged, that the connection between the two produces to the resident person either no profits or less than the ordinary profits which might be expected to arise from that business.

Again, where the profits on which the non-resident person is chargeable in the name of a resident person cannot be readily ascertained, the Commissioners may assess the non-resident on a percentage of the turnover of the business done by the non-resident person through or with the resident person. In such a case returns and statements with regard to the business done can be called for from the resident.

The determination of the percentage for this purpose is at the discretion of the Commissioners concerned, subject to the right of appeal in the case of an assessment made by the Additional Commissioners to the General or Special Commissioners, and to a further appeal by the resident or non-resident person (provided such further appeal is lodged within four months of the determination on the previous appeal) to a Referee or Board of Referees to be appointed by the Treasury. The decision of such Referee or Board is final and conclusive.

The above rule does not operate to make the non-resident person chargeable in the name of a *broker or general commission agent*, or in the name of an agent who is not an authorised person carrying on a regular agency of the non-resident person, on profits or gains arising from sales or transactions carried out through such a broker or agent.

Where a resident in Britain is chargeable for a non-resident person and the profit or gains in respect of which he is chargeable arise *from the sale of goods or produce manufactured or produced out of Britain by the non-resident person, the resident person* so chargeable may apply to the Commissioners concerned, with the ordinary rights of appeal, to have the assessment in respect of those profits made or amended on the basis of the profits which might reasonably be expected to have been earned by a person (or merchant, if the goods are retailed by or on behalf of the manufacturer or producer) who had bought from the manufacturer or producer direct.

The assessability of the foreigner to British Income Tax presents many difficulties to the Inland Revenue Authorities, and the foregoing provisions, while they have done much to facilitate the assessment of the profits and the collection of tax, are by no means exhaustive, and the position of the Inland Revenue with regard to recovery of tax from the foreigner who is liable is still somewhat insecure.

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